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VOL. X

CORPORATE PROMOTIONS AND REORGANIZATIONS

BY

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TO MY FATHER

CHARLES H. DEWING

IN GRATITUDE

PREFACE

The tendency toward combination in certain industries has attracted attention from three distinct groups of people. The student of economic history has seen in the movement a phenomenon as far reaching in its consequences as was the industrial revolution a century ago; the business man, from practical motives, has recognized in it a means for increased profits with lessened effort; the politician has interpreted it as an attack upon the inherited liberties of our people. Unfortunately, with but few exceptions, broad statements are made with insecure foundations in fact, though often in terms of impassioned oratory.

The following studies were prepared for the purpose of surveying in detail the stages in the life histories of a selected group of industrial combinations. The cases chosen have all passed through a somewhat complex cycle, in which promotion, failure, and reorganization followed each other. Such cases illustrate best all phases of corporate history in a comparatively brief space. The student should not infer, however, that all industrial combinations have been as unfortunate as those described here. On the contrary many combinations promoted as extravagantly as any of these have enjoyed uninterrupted prosperity.

I hold no brief for any particular public policy toward industrial combinations. I have sought to depict the facts as I have found them, without effort to shield persons or opinions, and without any ulterior motive. Nevertheless, I have been impressed throughout by the powerlessness of mere aggregates of capital to hold monopoly; I have been impressed, too, by the tremendous importance of individual, innate ability, or its lack, in determining the success or failure of any enterprise. With these observations in mind, one may hazard the belief that whatever " trust problem " exists will work out its own solution.

The doom of the inefficient waits on no legislative regulation. It is rather delayed thereby. Restrictive regulation will perpetuate the inefficient corporation, by furnishing an artificial prop to support natural weakness; it will hamper the efficient by impeding the free play of personal ambition.

In the preparation of this book I have been under deep obligation to the many business men who have given me ungrudgingly of their time and their interest. Without their help the studies would have been bare statistical skeletons without vitality. I am, too, much indebted to my past students, particularly certain industrious undergraduates at Harvard who have procured most valuable facts for me, and I wish to thank Professor William Z. Ripley of Harvard for inspiration in undertaking these studies, and the Corporation of Harvard College for appropriating money necessary to print them. I am above all indebted to my father for his great labor and accuracy in the detail of preparation.

A. S. D.

PETERSHAM, MASSACHUSETTS.
August, 23, 1913.

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CORPORATE PROMOTIONS AND REORGANIZATIONS

CORPORATE PROMOTIONS AND REORGANIZATIONS

CHAPTER I

INTRODUCTION

THIS book is a study in the financial policy of certain industrial corporations which at one time or another have found it necessary to undergo a reorganization of their capitalization. The student of medical science is often impressed with the light the study of the abnormal and irregular throws on the normal and natural processes of life; one may hope that an analysis of the pathological instances of industrial enterprise may be equally instructive regarding the normal functioning of a healthy and successful industrial corporation.

These studies deal with certain specially selected cases only. They are not exhaustive. Since 1890, many industrial enterprises of varying magnitude have met reverses and have undergone distinct and fundamental changes in their financial organization. A few only of these are discussed in the following pages; but these few have been selected for their importance, and for the specific forms of failure and reorganization they illustrate. Effort has been made to present each case in sufficient detail to give it the individuality that belongs to concrete cases. All attempts to form generalizations have been postponed to the closing chapters of the book. This emphasis on detail has frequently forced the consideration of personal characteristics which do not necessarily form a part of a bare statistical outline. Such inclusions have been intentional, for the forces behind the outward form of statistical facts are personal. No business ever developed into a conspicuous success or a conspicuous failure except through the ability or lack of ability of men. Corporations, outwardly the

most impersonal of the elements in our industrial organization, are in reality intensely human.

The history of each of the corporations here considered may be divided into three parts, — the period of promotion, the period leading to failure, and the period of reorganization and possible resuscitation. The period of promotion is often characterized by extravagant confidence in the economies of large-scale production and by excessive issues of securities. This was the case with the Cordage, Malting, Asphalt, and Shipbuilding promotions.[1] The period may, on the other hand, be one of mere growth in which a small business expands to wide dimensions and gradually, through internal growth alone, takes on the form of a large industrial unit. This was the case with the Westinghouse and with the American Glue Companies. The period of failure is usually one of long duration, and although it is often directly occasioned by the extravagances of the promotion, its crisis may not occur for some years. Hugh Miller, placed as a young man in charge of a small branch bank, once remarked that he found little difficulty in determining those of his customers who were on the verge of failure, but that he gave too little importance to the extraordinary efforts a man will make as he approaches financial ruin, and the failure invariably occurred later than he had anticipated. So it is with the large corporations. A failure may be clearly indicated by every significant sign, and yet the crisis be postponed for a surprising length of time. It is usual, therefore, to find the period of failure relatively long, and marked by continued decline in the earning power of the corporation, rather than by declining credit as one might expect. The crisis finally seems to come as the direct consequence of some insignificant change, — such as the tightening of the money market, or the rise in the cost of labor or materials; but, in the majority of instances it will be found to be really due to the operation of deep-seated and far-reaching causes that have been operating over a relatively long period of time. The period of reorganization is the period of reconstruction. Either the directors themselves or independent interests seek to set right what appears to be wrong. Additional capital is usually

[1] See later Chapters.

obtained. Often success results; still oftener the fundamental causes of disaster are not removed and the business has to pass through a second, third or even fourth reorganization.

A sufficiently radical readjustment of the capital liabilities of a corporation to warrant us in calling the case a reorganization is almost always occasioned by a failure of some kind. But the conception of corporate failure is much less precise than would at first appear. At the very outset it is necessary to distinguish between failure in the legal sense and failure in the business sense. The objective fact that a corporation is unable to meet its just obligations as they become due, which determines failure in the legal sense, is a conception at once too broad and too narrow for our purposes. It is too broad because corporations may become technically insolvent when they have continuously earned ample returns on the capital invested and are possessed of sufficient assets to meet their liabilities but yet are unable to realize upon them at once. The technical insolvency of the Westinghouse Company in the autumn of 1907 [1] is a case in point. The assets were ample and the enterprise successful, — wages, interest, and liberal business profits had been paid, and could still have been paid had it not been for extraordinary financial conditions. The legal definition is too narrow because a corporation may be able to meet its current liabilities as they fall due, but fail to earn sufficient margin to pay normal interest on the capital invested and normal profits to the business skill which manages it. If the capital invested is represented by stock rather than bonds, and so cannot demand its interest at law, or if the men in administrative offices are content with meager salaries, and do not claim normal profits, the business is able to eke out a continued existence without becoming legally bankrupt. In the economic sense it is a failure though legally it is not. It is, in fact, a much more serious failure than one such as the Westinghouse insolvency, because the causes are more fundamental.

Whether or not an unsuccessful business comes under the review of the courts depends largely on the form of the capitalization items, — whether these are entirely stock or are stock

[1] *Infra*, Chapter VII.

and bonds. The reason why upwards of 40% of the railway mileage of the country passed into receivers' hands during the depression following the panic of 1893 was that a large part of the capitalization of these railroads was represented by bonds carrying fixed charges enforceable at law. The reason why so few of the industrial consolidations failed, in the legal sense of the word, during the depressions of 1903 and 1907 was that practically all their entire capitalization was in the form of stocks with no legally enforceable claims to interest and profits. This is a matter of great practical significance, — an enterprise may be a business success or failure but whether it is compelled by the courts to face financial readjustment will not depend so much on this as on the form of its capitalization. In a later section of this book, one dealing with the causes of failure, the attempt is made to further classify various forms of lack of success in business; but the present purposes of an introduction merely require us to note that lack of success in some form lies at the basis of any crisis in the company's affairs which leads to a reorganization, but that this lack of success may or may not be such as to come under the review of the courts.

A reorganization is a financial readjustment of a pronounced character. It is the alternative to the cessation of business and the winding up of the corporation's affairs. Small businesses that have failed may be liquidated without serious consequence to any except those directly responsible for the misfortune. Large businesses are different. Their importance to the community is great, and the interests behind them are varied and powerful. Liquidation of their assets would under the very best conditions involve waste and sacrifice. The most valuable things in an established business are frequently its trade-marks, its good-will, its trade connections, and above all, its organization. These are intangible; they would be destroyed if the business were disintegrated and its assets given over to other hands and other uses. Not infrequently, the salable property of a corporation would not bring an amount sufficient to reimburse the first mortgage bondholders or even the merchandise creditors. Under ordinary circumstances, therefore, when the

business operates in an industry where normal profits may be expected, it is better for the creditors and the stockholders to arrange some readjustment of liabilities, so that the business may be continued as an organized unit even though creditors as well as stockholders make a temporary sacrifice. A corporation like the Westinghouse Electric Company manufactures machinery absolutely essential to our present stage of industrial development. It would have put a distinct burden upon the public had this Company been compelled to give up its business at the time of the failure in 1907, and so remove its competition in the field of heavy electrical equipment. To build up another organization from the fragments of the old would have involved the expenditure of capital that could better be used in other lines of production. At the time of its insolvency, the court used every possible means to help put the Company on its feet with the least interruption to its business, believing the interests of the creditors, the stockholders and the community would be better protected by this policy than by allowing the organization of the Company to be broken up. The commercial world waited anxiously the consummation of the reorganization, and the announcement of the termination of the receivership was considered a sign of returning business prosperity.

It will be convenient for us to understand, for purposes of provisional definition, that *a corporate reorganization is the form of financial readjustment adopted in the presence of real or threatened financial trouble, in order that the business of the corporation may be continued under more favorable conditions.* It follows a crisis of some kind. It always involves a conspicuous readjustment of the capital liabilities, ordinarily accompanied by a reduction in fixed charges, and by the addition of new capital. To accomplish these ends pressure usually has to be brought to bear upon the various classes of security holders but as has been said legal insolvency is not always necessary in order to bring about concerted action. The readjustment may be entirely voluntary on the part of the people directly concerned. The immediate conscious purpose is always to relieve an emergency by abrupt means; the ulterior purpose is to rehabilitate the

finances of the corporation, so that it may continue in business under improved conditions.

The definition of reorganization given by Dr. Daggett in his study of railroad reorganizations cannot be applied successfully to the reorganization of industrial corporations. "The term is used," he says of his own study of railroads, "to denote the exchange of new securities for the principal outstanding, unmatured, general mortgage bonds, or for at least 50% of the unmatured junior mortgages of any company, or for the whole of the capital stock."[1] It should be noted that industrial reorganizations occur very frequently in which no such exchange is needed, as in the two Westinghouse reorganizations.[2] It often happens, also, that a reorganization is accomplished by merely superimposing new securities over the old, — as in the American Malting Company's reorganization of 1899, when the stockholders consented to the liquidation of debts by the issue of first mortgage bonds.[3] As a general rule, too, industrial reorganizations are simpler than those of railroad corporations. The original forms of capitalization are less varied. There are not so many different issues of securities to be refunded nor are there so many conflicting interests involved. Further, since they are manufacturing businesses, with, relative to the railroads, small investment in plant and large requirements for working capital, their reorganizations have turned quite as much on the provisions for new capital, as on the exchange of new securities for old.

The point in common among all reorganizations is that sacrifices have to be made by the holders of securities, but the nature of these sacrifices must differ according to the nature of the enterprise and the seriousness of the failure.[4] In the reorganizations of industrial corporations the security holders play a

[1] Daggett, *Railroad Reorganization*, p. 335. Harvard Economic Studies, Vol. IV.

[2] *Infra*, Chapter VII.

[3] *Infra*, Chapter XI.

[4] In a strict sense, these remarks pertain only to reorganizations succeeding lack of success. Of late, the Standard Oil, Tobacco, and Powder reorganizations have introduced a new type.

relatively more important part and the courts a relatively less important part than experience has shown to be the case in those of either railway or traction companies. As a result, the burden of making an equitable adjustment of the responsibilities and sacrifices between the various classes of security holders falls more upon the shoulders of the security holders themselves. The courts have shown less willingness to bring judicial pressure to bear, and more inclination to insist that the various parties concerned shall arrange their differences among themselves. They have also shown more willingness to allow bondholders to exact the full measure of their contract, so that, as a rule, mortgage bondholders have been less harshly treated in industrial reorganizations than in railroad reorganizations.

Besides the wage earners,[1] there are four classes of persons who are directly interested in the financial success of a large corporation. The first is that of the bondholders who have frequently a direct lien on the corporation's physical property. They have usually had no voice in the management, and have been led to invest their money in the enterprise because of apparent certainty of income, and apparent margin of assets over liabilities. Their obligations are usually long standing, and mature only after a considerable period of time. The second class is the holders of short time obligations and open accounts, — the banks and the merchandise creditors. These men have been more alert to the situation than the bondholders, because they have been in closer touch with the business. Their claims to earnings are usually second to those of the bondholders. The third group concerned is the stockholders. They are the legal owners of the business, and in a strict economic sense, are the entrepreneurs. Because of the diversification of stockholdings, there has arisen the practice of delegating the managerial function of the stockholders to a selected group, which, for the present purposes, we will call the officers of the corporation.[2]

[1] The wage earners sometimes contribute money in order to put a business on its feet after a financial crisis, see Westinghouse Electric and Manufacturing Company. *Infra*, p. 193.

[2] The old policy of selecting one of the largest stockholders to act as President still obtains in most small corporations and some large ones. The general ten-

They constitute the fourth class of interests. The distribution of the income of the corporation is in the order of the risk assumed by the various interests. The income received by the bondholders is largely interest, with only so much of economic profit as shall compensate them for their slight risk. As long as the corporation remains solvent their charges must be met. The bank creditors take greater risk, because their claims follow those of the bondholders; their "interest" has, therefore, more of the element of economic profit than that of the bondholders. The shareholders, in strict speech, receive a return entirely as profits; but as most corporations have assets in excess of interest-bearing liabilities, some of their return must be considered interest on this excess. Of late years, especially with industrial corporations having no bonds, the shareholders' return is largely interest. At all events it comes after payments to the debtholders. Lastly, the administrative officials receive salaries for managing the enterprise, which are nothing else than pure economic profits, payments for entrepreneur ability.

The attitude of both the courts and public policy recognizes the economic distinctions just defined. In either the liquidation of the assets of a corporation, or in its reorganization, interest-bearing securities take precedence over those which claim the earnings as profits. And this is in accordance with strict economic theory, for profits have an economic justification only as compensation for risk and skill of management. When the corporation fails, the very failure attests to unfortunate assumption of risk and misdirected business ability. The old management ceases to exist the moment receivers are appointed, and

dency, however, is different. In a large number of instances, the President is a paid official, to whom is delegated the actual responsibility for managing the business. Many of the railroad and large industrial Presidents own but few shares in their corporations. Their powers are merely representative of the members of the Board of Directors, who in turn carry, in detailed administration, the risk and responsibility of the stockholders. Under this alignement of interests, the President is entirely an entrepreneur, and his salary pure economic profit. The position of "most influential stockholder" is now taken ordinarily by "The Chairman of Board," who receives no salary, and whose only economic profits arise through dividend disbursements, or enhancement of stock values, due to skill of management.

even in a voluntary reorganization, new officers usually take the place of the old. Their services were those of the entrepreneur, and the mere necessity of reorganization indicates the probable inadequacy of these services. The shareholders are next affected. Their part is that of the owners and profit sharers upon whose shoulders falls the chief responsibility of selecting the management, if not the actual management itself. To them the profits of the enterprise, in the form of dividends, have come in the past, or would come in the future. Had the business been successful, they would have reaped the largest benefit; it being a failure, they must bear the brunt of the burden. The holders of the floating debt come third in sharing the sacrifices. Usually astute bankers, they are in a position to gauge the enterprise, and the income on their notes carries, ordinarily, a liberal margin above pure interest, to compensate for their risk. Lastly come the bondholders, whose position must be most secure, because they were least of all sharers in the risk and responsibility of the enterprise. Every reorganization in the history of our American finance has borne heaviest upon the officers and stockholders of the corporation, and lightest upon its bondholders. There are, it is true, degrees of sacrifice. Holders of preferred stock take precedence over the holders of common stock, holders of first mortgage bonds over the holders of debenture bonds; but the theory of the distribution of the burden is the same, the greater the element of economic profit in the income return, the greater the sacrifice in the reorganization.

The sources of material used in the preparation of these studies have been three, — (*a*) Publications, where facts were given out by the corporation officials, or authorized by them; (*b*) Reorganization Committee, Court, and Government records; (*c*) Personal interviews.

(*a*) Of the published material the first to be mentioned is that actually published by the corporation itself. This comprises stockholders' annual reports, circulars to stockholders and in some cases to customers, letters to bankers for publication, and the various bankers' and attorneys' letters always scattered

broadcast at the time of promotion, reorganization, or change of capitalization. These are, of course, the most direct sources available. They are, however, invariably colored by the point of view of the corporation, and frequently unreliable because of "sins of omission." The other publications include "authorized" statements in the financial columns of the daily press and in the regular financial journals. Sometimes, but not frequently, these items embody criticisms from financial writers, or expressions of opinion and recitals of facts not directly authorized by the corporations. As a general rule, however, the statements of the press comprise merely the facts made public through the publicity department of the corporation, or unreliable quotations and hearsays, — the "news" upon which the stock-market trader feeds. In some cases, they are covert attempts to influence the investing public by the insidious "write-up," with which many financial papers prostitute their pages.[1] Distinctly the most useful publication that we have is the *Commercial and Financial Chronicle.* Its accuracy is striking. Over and over again the present writer has compared original reorganization plans and corporation reports with the *Chronicle* digests, and almost without exception[2] no important error has been discovered. The files of the *Chronicle*, too, are accessible to most people, and thus this source has been referred to whenever references to current "news" seemed necessary.

[1] Corporations and bankers have so much at stake in making a good impression on the public, that serious criticism, except in the most flagrant cases of fraud, seems difficult to obtain. It is always easier to print the good side; and the evil of misrepresentation by omitting to print the bad side is so indirect and diffuse that few publications which depend for their existence on advertising have the courage to do so. The ordinary "write-up" is perhaps the worst form, for its fraudulent character is less easily recognized by the uninformed investor whose eye it is intended to catch. Few people realize how numerous are the small financial journals and investors' magazines, and large ones, too, for that matter, which owe their existence to this deceitful form of advertising. What we want in this country is an unflinchable financial publication, conducted for love of the subject like the scientific and learned publications.

It is important to note that the manager of the *Boston News Bureau* and the *Wall Street Journal* is also the proprietor of a financial advertising agency.

[2] The most serious errors noted were in connection with the United States Shipbuilding Company; but nobody seemed to know the truth in connection with this concern.

(*b*) The second class of material comprises the reports of reorganization committees, of court litigation, and of government commissions. These documents are usually not biased in favor of the corporation or its officials, but not infrequently, they show bias in the other direction.[1] That tendency must be carefully considered, in giving polemical documents their proper equation. The reports of reorganization committees are very valuable, because intended usually to explain the reasons for the failure. Although these reasons do not always strike to the root of the trouble, they often suggest where to look for it. Such reports are, of course, ephemeral and issued for the specific purpose of influencing the action of a large body of stockholders; but they are written by men who have had access to the books and files of the corporation and commonly by men of high standing in the business world who would not allow their names to be used in connection with the statement of unreliable facts.[2] Court records are developed in litigation. The facts they show are, therefore, colored by the ends sought by the litigants. The best of these records, when the bills of plaintiff and defendant are read together, afford very accurate and reliable information. If the company passed into the hands of the court, the receiver's report is usually valuable.[3] Of all this class of material, the government publications and reports seem least important. Volumes of the Industrial Commission of 1901 are useful to some extent, but the new material found there is disappointing. The men examined were on the defense, and the examiners seem to have developed the testimony along preconceived lines determined by motives of political expediency. Then, too, there is hardly any evidence developed by the Commission that could not be obtained better elsewhere. One finds there, however, reprints of important plans and agreements, not otherwise

[1] The Receiver's Report of the United States Shipbuilding Company, for example, was intended to influence public opinion against the corporation, and particularly against one man.

[2] The Uhlmann Committee Report, in the American Malting Company case, and the Biddle Report, in the Asphalt case; are excellent examples of this kind of material.

[3] Henry Tatnall's reports in the Asphalt Companies case are excellent examples of full and courageous receivers' reports.

accessible to the general reader. Reference to these Industrial Commission Reports has been made wherever possible, because of that ease of reference, but the student of corporations must remember that political motives are quite generally prominent in all government "trust investigations." [1] The various volumes of the Bureau of Corporations contain a large amount of matter, but its scientific value is distinctly lessened by the unwillingness of the Bureau to give the sources and authorities upon which its facts and judgments are based. Because of the prejudices of the men connected with the Bureau their estimates and judgments have been neither reliable nor permanently significant.[2]

The most valuable source of information accessible is the memories of the men who have been connected with the growth of our large business enterprises. When one realizes that the great industrial consolidations have developed in the immediate past, and that many of the chief actors are still alive, the importance and value of evidence of this kind is at once apparent. Much of the outward history of corporations could be written many years hence, but an intimate knowledge of the motives that underlie this history can be written, if at all, only at the present time. Of course such testimony needs to be checked, and is subject to the errors resulting from lapse of memory, and from misrepresentation; but when properly used, it gives flesh and blood to the statistical skeleton. The evidence given by two classes of persons is especially valuable, the promoters and corporation officials on the one hand, and the competitors and business antagonists on the other. There are cases when the descriptions of the same episode, as given by these two groups

[1] There is a willingness on the part of students of corporation finance to place an uncritical confidence in reports on corporations by government commissions merely because published by the governmental authority. It should be remembered that such investigations as the Stanley Committee on the United States Steel Corporation and the Pujo Committee on banking integration were instigated by Wall Street "wolves," prompted largely by political motives and conducted by men with little knowledge of their subjects and no special qualifications for the investigation.

[2] As, for examples, the Report of the United States Steel Corporation and the International Harvester Corporation.

of men, are hardly compatible; but in the large majority of cases, business men face the truth with simplicity and openness, whatever their private interests may be. When two men of entirely different view-points, and biased by different and obviously opposing motives agree in the explanation of a transaction there is good reason to believe in the authenticity of their common testimony. In gathering this kind of material it has been found wise to go directly to the men concerned. Sometimes this has been done by personal interviews, sometimes by the submission of direct questions and sometimes by requests for comments on phases of corporation history with which they were intimately and personally familiar. As a general rule the writer of these studies has found that the "nearer the top" a man was, the more willingness he showed to coöperate in making these studies complete in detail.

CHAPTER II

The United States Leather Company

Economic disadvantages of combination in the sole leather industry, 17; promotion of the United States Leather Company, 18; early and continued failure of the Company, 21; speculative character of its stocks, 23; underlying causes of its failure, 24; first plan of financial readjustment, 26; first plan of reorganization and the reasons for its lapse, 27; revaluation of the assets of the Company, and plan of reorganization on basis of newly-discovered assets, 29; motive back of this plan, 31; final plan of reorganization, 33; justice of this plan, 39; subsequent litigation and the settlement, 44; summary of conditions, 47.

Chronological Summary

1892. Agreement not to wet hides for six months.
1893. Organization of the United States Leather Company.
1899. Plan for paying accumulated dividends first suggested.
First plan of reorganization unsuccessful.
1902. Revaluation of Company's timber lands.
1903. Second plan of reorganization unsuccessful.
1904. Final plan of reorganization proposed.
1905. Announcement of successful operation of plan.
Incorporation of Central Leather Company.
1906. Attempted merger of the two Companies.
1907. Beginning of the Colgate litigation.
1909. Decision of the New Jersey court against the merger.
Final settlement of litigation out of court.

The reorganization of the United States Leather Company into the Central Leather Company affords one of the simplest and most instructive examples of modern reorganization finance. The financial difficulties of the Company grew out of the highly competitive character of the leather industry combined with the need of an abundance of working capital which the tanning of hides on a large scale requires. To these economic conditions was added the fact that the preferred stock, carrying heavy preferential dividends, was issued largely to acquire unproductive timber lands. The reorganization itself involved the question of the rights of preferred shareholders to accumulated but unpaid dividends and to a book-keeping surplus arising out of the supposed increase in value of tangible assets.

The sole leather industry does not lend itself readily to large-scale production. Little capital for plant is required, in proportion to the output; the raw materials (hide and bark) are purchased in a highly competitive market, and the finished product is sold under equally keen conditions of competition. The American tanners buy their raw Argentina hides in competition with Canadian and European tanners, and they sell their leather in competition with the leather of these same tanners. The markets in which they buy and sell are, therefore, world-wide in scope. No large amount of skilled labor of a technical order is required, for the tanning of hides is a long-time process in which the cost of labor is subordinate to the cost of the raw material. The small tanner who is near his bark lands can, indeed, tan a few hides a week quite as cheaply as the large tanner, further removed, can tan a hundred or a thousand times as many. Under these conditions it would seem that American tanners could derive little advantage from consolidation. Yet, in spite of these underlying facts, the sole leather industry was one of the first to resort to centralized organization in the hope of allaying the disastrous results of competition and enhancing the profits through large-scale production. At the time this consolidation was formed, moreover, it was represented by the only corporation in the country with a capitalization well over a hundred million dollars. Viewing the matter broadly, then, we seem to have here a huge capitalistic combination seeking to apply the methods of large-scale production without the prop of a natural or legal monopoly and in the face of those economic conditions which favor small-scale production.

A considerable part of the heavy sole leather of the country is tanned in Pennsylvania and southern New York state. Near are the large hemlock and oak forests which yield the bark upon which the tanning industry depends. For a considerable period of time, until perhaps 1880, the tanners experienced no difficulty in obtaining all the bark they needed at nominal prices. Gradually, however, as the more available sections of forest land were cut, and the bark became dearer, the tanners themselves began to acquire extensive areas of timber land in order to safeguard

their supplies. Each tanner bought the land as it was offered without much regard to the question of whether it was nearer his own tannery or that of a competitor. As a result the various timber holdings became so intermingled that economical exploitation of the bark lands was impossible. The price of sole leather fell steadily from 1884 to 1891, and competition among the tanners grew increasingly severe. In 1892 there were signs of marked over-production. As a result the large tanners entered into an agreement not to wet any more hides for a period of sixty days. The plan worked excellently and the tanners were able to dispose of their surplus stocks without suffering a loss.

The favorable outcome of the agreement of 1892 and the widely recognized success of the oil, whisky, and sugar combinations led five of the largest tanning interests to consider the possibility of making a more economical use of their bark lands by merging their different interests in one company. The bark for each tannery could then be obtained from the nearest source, — obviously an economy of operation, — and with the control of a large proportion of the available bark, with economical methods of manufacture and decreased selling expenses, the tanners believed they would be able to produce leather more cheaply than their competitors. Then, too, some of the older men were desirous of organizing their business affairs so that their estates could be administered easily in case of their death. These were the chief reasons which led to the formation of the United States Leather Company in the spring of 1893.

The leaders of the movement appointed committees to appraise the tanneries and bark lands owned by the interests that had consented to enter the consolidation. The property was then acquired by the consolidated company on the basis of the appraisals by issuing $100 in preferred stock and $100 in common stock in return for each $100 in the appraised value of the property. In other words, the Company paid for the tanneries and bark lands by issuing its preferred stock and by giving an equal amount of common stock as a bonus. In this way the leaders of the movement acquired approximately 110 tanneries,

controlled by some 60 leather houses. Besides the tanning properties the combination acquired about 400,000 acres of bark land and the bark rights on nearly 100,000 more. At the outset, the combination controlled approximately 72% of the country's output of hemlock tanned leather, about 30% of the oak tanned and about 45% of the union tanned leather. From various lines of evidence it appears that the strongest firms in the hemlock branch of the industry went into the combination, but the more prosperous oak and union tanners refused to enter, largely because they were not offered sufficiently liberal terms. It is fair to say that the United States Leather Company controlled, at its inception, about 58% of the sole leather tanned in the country. No promoter was instrumental in forming the consolidation. Even bankers were not resorted to except for the sale of a small issue of debenture bonds. The formation of the Company may be looked upon, therefore, as typical of those cases in which manufacturers themselves united their businesses in the hopes of obtaining the economies of combination, and large-scale production.

The United States Leather Company was incorporated in New Jersey, February 25, 1893 under the old "Act Concerning Corporations" approved April 7, 1875.[1] The certificate of incorporation was afterward amended[2] several times. The important items of its early financing can be expressed in a nutshell as follows. The authorized capital consisted of $64,000,000 preferred and the same amount of common stock. Of these amounts there were issued, after various adjustments had been made, $62,282,300 of the preferred and $62,882,300 of the common.[3] The preferred stock carried 8% cumulative preferential dividends, to be paid from the net earnings of the business. This was preferred both as to dividends and to assets in case of liquidation. Working capital was furnished by an issue of $10,000,000, debenture bonds of which $6,000,000 were

[1] 1877, *Revised Statutes*, 175; *General Statutes*, 907.

[2] Amended certificate dated April 29, 1893.

[3] The capitalization items were somewhat less at the very beginning on account of incomplete inventories of subsidiary holdings.

underwritten and issued at par through a syndicate managed by Heidelbach, Ickelheimer and Company; 4% of these bonds were to be retired each year at not over 110%. The preferred stock was issued as has been said in return for the property of the various subsidiary tanners. With each share of the preferred stock was given a single share of the common and $600,000 par value of the common stock was also given to the syndicate underwriters as a 10% commission for underwriting the debenture bonds.[1] Using the figures derived from the appraisals, it would appear that the United States Leather Company was possessed, at its inception, of property to the value of $63,000,000. Distinctly different opinions exist as to whether the appraisals were fair. The tanners who sold their property to the Company considered them just, whereas tanners not within the combination considered them clear inflations of the actual value of the property.[2] The greater part of the property consisted of bark lands. These were acquired on a basis of $2.50 a cord for lands bought outright and $.50 a cord for lands with bark rights alone.[3] These bases appear from other lines of evidence to be just. There may have been an over-valuation of the tannery property.[4] All things considered, however, it seems fair to believe that the property acquired by the United States Leather Company had an actual market value of $60,000,000, including the $6,000,000 in money obtained from the bankers. Against these assets the Company issued $131,000,000 of securities, for nearly half of which the tanners admitted there was nothing tangible. The charges, including the cumulative dividends, required $5,342,584.

[1] XIII *Report of the Industrial Commission of 1901*, p. 686. (The reports of the Industrial Commission are hereafter referred to as *R. I. C.*)

[2] Of the various "outside" tanners, whose opinions have been obtained, several believed the values "liberal," but not necessarily excessive. One believed the appraisals "double the actual value," another "very much greater." Those who spoke disparagingly of the fairness of the appraisals showed by other comments that they were unfriendly toward the consolidation.

[3] Listing Application to the New York Stock Exchange, dated June 21, 1893. (The listing of the 6% debenture bonds.)

[4] The tanneries were valued on the basis of their vat capacity. The estimates appear too large on the basis of reproduction cost.

The financial position of the United States Leather Company with respect to other capitalistic combinations of the time deserves some comment. At its formation in 1893 it had the largest book capitalization of any American industrial corporation. The component companies of the recently dissolved Standard Oil Trust had at that time a little over $102,000,000; the American Sugar Refining Company had an authorized capital of $75,000,000; the National Lead Company a little less than $30,000,000; the American Tobacco Company $35,000,000; and the United States Rubber Company $50,000,000. All the other industrial combinations then in existence had yet smaller capitalizations.

The capitalization figures of the United States Leather Company express the unbounded optimism with which the leaders of the enterprise entered into the work of managing the new combination. The old leather interests, represented by men who had conducted their separate businesses for thirty years and more under conditions of free competition, believed that the low price of the finished product was directly attributable to the severity of competition. They confidently expected that when the economies of combination had been introduced, a period of high prices and trade prosperity would necessarily follow. According to a prospectus issued at the time the Company was formed, the constituent tanners had been making net profits of over $4,800,000.[1] This statement was made in face of the fact that the business had been demoralized for two and a half years preceding. In addition the tanners believed they would achieve large economies by reducing the number of salesmen and sub-agencies and by closing the tanneries less advantageously situated.[2] In spite of these economies, however, the immediate

[1] "The principal vendors state that from their knowledge of their own, earnings for the past five years of the businesses which have been conveyed to the Company have exceeded eight times the amount needed to pay the annual interest and sinking fund charges upon the six million debentures now issued."

[2] These economies were undoubtedly introduced. The closing of the tanneries is reflected by the fact that the United States Census records 1.749 plants in the country for 1890 and 1,309 in 1900. These figures show the general tendency toward concentration but do not, of course, reflect alone the conditions brought about by the formation of the United States Leather Company.

result of the combination was failure. During the first year of its history the United States Leather Company showed a net loss of approximately $1,340,000,[1] Subsequently its net earnings increased, but in no year of its history did they warrant the declaration of the full 8% dividend on the preferred stock which the original contract between the corporation and its stockholders required. In 1895, the Company paid 6%. Rumors were circulated, as an "unauthorized assertion by one of the directors," —[2] that the preferred would soon be put on the full 8% basis. The following year, instead of this, the preferred shareholders received merely 1%.[3] Needless to say, no dividend was paid on the common stock.

The failure of the Leather Company to earn the expected dividends, coupled with its heavy capitalization, gave both the

[1] 60 *Commercial and Financial Chronicle*, 391. (The references to the *Commercial and Financial Chronicle* are hereafter abbreviated, *Chron.*)

[2] 62 *Chron.* 412.

[3] The following table indicates the amount of dividends paid, the earnings, and the accumulated unpaid dividends from the beginning of the company. The earnings represent net earnings applicable to dividends, after the payments of interest on debentures. It is assumed that the payments to the sinking fund of the debentures represent a proper charge to depreciation and may therefore be deducted before determining gross earnings. The dividends were cumulative from May, 1893, which accounts for the fractions.

Year	Earnings	On Pref. Earned %	On Pref. Paid %	Amount Paid On Pref Stock	Accumulated Div. on Pref Unpaid
May 1, '93 to Apr. 30, '94	−$1,340,494	−2			
May 1, '93 to Dec. 31, '94	+ 726,473	1.1			
1895	9,359,833	15	6	$3,736,938	
1896	− 2,017,037	−3	1	622,823	$21.33
1897	3,237,372	5	4¾	2,958,409	25.33
1898	1,821,921	3	4	2,491,292	28.33
1899	4,947,601	8	5	3,114,115	31.08
1900	2,281,511	3	6	3,736,938	33.08
1901	5,888,455	9½	6	3,736,938	35.08
1902	4,595,589	7	6	3,736,938	37.08
1903	1,086,095	1½	6	3,736,938	39.08
1904	3,645,267	6	6	3,736,938	41.08
Total to Jan. 1, 1905 (Time of reorganization)	$35,573,080	....	..	$31,608,267	
1905	6,178,457	10	6	3,736,938	43.08
	$41,751,537	....	..	$35,345,205	

Total surplus from net earnings at time of reorganization, Jan. 6, 1905, $3,964,813.

common and preferred stocks a highly speculative character. During 1894 the market price of the preferred stock ranged, with considerable fluctuation, about $60 a share. The following May, because of the somewhat larger earnings, and also the wide circulation of that "unauthorized assertion of one of the directors" that the full 8% would soon be paid, the price of the preferred stock reached almost its par value. This was the highest point the stock attained until the time of the reorganization of the Company nearly ten years later. In 1896 the Company was operating its tanneries at a loss and the market price of the preferred stock declined to about $40 per share. During this period the common stock had a mere nominal quotation of $5.

In the years immediately following, the stocks of the Leather Company were little more than speculative dice for Wall Street. The failure of the preferred stock to receive the full 8% dividends, any unpaid balance being cumulative, gave that glamor of the unpredictable upon which stock speculation thrives. The common stock had hardly this interest. Speculation is most active in low-priced, non-dividend paying securities, but even these must have some pretence to value, either actual or potential. The common stock of the Leather Company had neither, apparently. Issued as a bonus to the holders of the preferred stock it was offset, in every balance sheet of the Company, by the highly suggestive phrase "good-will, etc." Any potential earnings it might ever have had were rapidly absorbed by the constantly accumulating load of unpaid dividends on the preferred stock. Its only possible value lay in the voting power it carried, and this was merely nominal, as the control was closely held by the original leather interests. The only exception to this dead level of neglect in the eleven years during which the common stock was quoted on the New York Stock Exchange occurred in November, 1899. Ordinarily the stock had been quoted within a narrow range between $5 and $10 per share. During October of that year it assumed increasing speculative activity until on the 25th its market quotation rose to $25 a share and on the 6th of November to $40.87. Two days later it fell back to $20 a share, and by November 29th it was again quoted at $10 a share.

During this brief period the original leather interests disposed of the greater part of their holdings of common stock, reserving for themselves and their families only the preferred stock.[1] The episode was caused by an attempt on the part of James R. Keene to "corner" the floating supply of the stock.[2] The leather interests in control of the Company had nothing to do with this episode and were annoyed at the time by the sudden activity of their security.

This history of the sole leather combination to 1899 is in sharp contrast to the optimism of its promoters. If one were asked to uncover the fundamental causes which explain the contrast, one would give three important reasons for the failure of the Company during the first years of its history.

The most potent causes for the early failure of the Leather Company lay in the general business depression which prevailed immediately after its formation. The Company began its life only two months before the failure of the National Cordage Company seriously injured the confidence of people in industrial combinations,[3] and only four months before the crisis of 1893 reached its most critical stages. The first four or five years following the panic of 1893 showed marked industrial stagnation. It is certain that, had the tanners recognized the full significance of the ominous signs in the business world they would not have formed the consolidation at that time. The relatively long time required for the manufacture of leather aggravated the difficulties resulting from the depression. Between the purchase

[1] The speculative character of this episode is illustrated by the large volume of sales. There were outstanding 628,823 shares of common stock. During the week from June 3 to 10, 1899, a fair illustration of the normal market, 350 shares were sold. During the week November 4th to 10th, 545,995 shares were sold, — nearly the entire issue of stock. November 7th was a holiday, so this represented an average market of 109,199 shares a day, for a stock which, six months before, had averaged about 50 shares a day. In the three weeks from October 21st to November 10th, 1,403,330 shares were sold, over twice the outstanding stock.

[2] It was generally believed by the officials of the Leather Company that Keene was acting for one of the Rockefellers who had become impressed with the potential value of the Company's bark lands and wished to acquire a large interest in the Company.

[3] *Infra*, p. 140.

of green "packer" hides in this country and the actual sale of the finished leather to the domestic consumer, from six months to a year elapses; and between the purchase of Argentina hides and the settlement with the foreign consumer this period may be extended to a year and a half. At a time of falling prices, like that of the middle nineties, the price of hides lags behind that of leather. As a result the Company found itself repeatedly compelled to sell leather for less than its cost of production. It was embarrassed, in the second place, by the large amount of unproductive assets for which it had issued its preferred stock. Part of this preferred stock was represented by bark which it had taken over in the expectation of an increase in business. When the expectation was not realized the heavy stock of bark acted as a dead weight upon the Company.[1] The bark lands, too, represented an investment upon which 8% in dividends were accumulating, yet they were without value until the Company could command enough remunerative business to warrant their use. In a very real sense the Company was "land poor." A third reason for lack of success lay in the competitive conditions of the tanning industry. Competition was inevitable and the small well-equipped tanneries were in a strongly intrenched position. This competition was not eliminated through the combination, as its promoters had hoped. The prices of leather were fixed on as competitive a basis after its formation as before. From the beginning the Leather Company feared the large, independent oak and union tanners, who controlled more than half the domestic output, since the oak and union tanned leather was quite largely consumed in the American market. The independent tanners had on their side the advantages of small-scale production and direct personal supervision over the process of manufacture. Even in the hemlock branch of the industry, where the United States Leather Company was dominant in this country, conditions were hardly less competitive. A very large part of this hemlock leather, made from Argentina hides,

[1] In addition to its own bark lands, the Company had entered into contracts for the annual purchase of considerable quantities of bark. Owing to the depression it could use only a part of these purchases, and thus stocks of bark accumulated while yet it was not in a position to utilize its own lands.

was exported to European markets where the American interests met the output of foreign tanners.

From the formation of the leather combination, dividends in arrears on the preferred stock accumulated. It was natural, therefore, that various efforts should be made which looked toward the adjustment of these dividend claims. During a period of eleven years, beginning in the early part of 1899 and extending until the settlement of the Colgate suit in the winter of 1910, the Leather Company was struggling to rehabilitate itself from the load occasioned by these claims. Four plans of reorganization were successively proposed and three were widely circulated. All but the last met with utter failure. The fourth plan of reorganization accomplished the desired end only after long protracted court litigation. In it, however, we are presented with one of the least complicated reorganizations in the recent history of corporation finance. It is this simplicity which makes the United States Leather Company reorganization important as a type of industrial readjustments.

The first plan of adjustment of which any rumor reached the financial world was proposed in the early part of 1899.[1] At this time the preferred stock itself was quoted about $75 a share and the accumulated unpaid dividends amounted to about $30 a share. The plan was to give to the preferred shareholders 10% of script in lieu of their claims to dividends. This proposition to pay the claims of a favored class of shareholders by script offers the simplest kind of an adjustment of a contingent liability. The only question that could arise would be as to the amount of the script. The preferred shareholders would demand the full face value of their claims; the common shareholders would naturally refuse this demand on the ground that the preferred shareholders, favored though they might be, were still stockholders, not bondholders, and, therefore, under an implied obligation to bear some of the burden of an enterprise which proved less successful than had been expected. Whether or not because of this difficulty, the plan failed in this instance. It was not even presented to the stockholders. Still, in many

[1] 69 *Chron.* 138.

respects, it was fairer to all concerned than any of the subsequent plans. It recognized the justice of the preferred stockholders' claim, and in the attempt to satisfy this claim it worked no hardship on the corporation itself, nor did it involve the sacrifice of any nominal though perhaps unreal rights of the common stockholders. No heavy reorganization expenses were involved. Its great defect lay in its failure to guard against difficulties arising from further accumulations of unpaid dividends in the future.

In this last particular the second plan of adjustment was a great improvement. On August 22, 1899, a committee was appointed by the Board of Directors "to consider the question of the settlement of back dividends on the preferred stock of the company and the extinction of the cumulative clause." [1] This committee was appointed a short time after the first plan was given up and the two attempts at adjustment were part of the same undertaking. The committee reported to the Board on the 4th of October, proposing that the preferred shareholders (1) surrender all claims to dividends already accumulated, (2) agree to the abolition of the cumulative element of their contract, (3) accept a non-cumulative dividend of 6%; and that in consideration of these concessions the common shareholders relinquish 50% of their holdings to the owners of the preferred stock. These provisions were embodied in a circular submitted to all stockholders under date of October 10, 1899. After giving an outline of the plan the circular goes on to state that the Directors recommend its acceptance because of the growing burden of cumulative dividends on the preferred stock, which " tends to injure the good name of the Company and is unjustly prejudicial to the stocks as investment." It is further suggested that it might be desirable that the common stock should have " a prospect of more immediate dividends." At this time the Directors held large amounts of common stock. Furthermore, it was urged that the removal of the cumulative feature on the preferred stock

[1] Colgate *v.* U. S. Leather Co., Chancery in N. J., Hoyt affidavit, p. 3. Reference is here made to the documents in the suit covering the reorganization into the Central Leather Company. These documents afford excellent sources of material covering the various plans of reorganization.

and the reduction of the dividends to 6% would prevent any similar trouble in the future.

This plan, like the first one, failed utterly. Out of 622,694 shares of preferred stock only 180,165 approved; out of the 628,694 shares of the common only 43,429 approved,[1]—less than a third in one case, and less than a tenth in the other. At first glance it seems as though the plan favored the preferred shareholders. This was not the case. The common stock was worth, during October, about $11 a share. The holder of a share of the preferred stock was, therefore, giving up over $30 in accumulated unpaid dividend claims, relinquishing his charter rights to 2% dividends each year and the cumulative feature attached to the remaining 6%, and in return receiving an amount of common stock which he could sell on the market for $5. The lapse of the plan was due probably to the unwillingness on the part of both classes of stockholders to face the fact that the enterprise was, when gauged by the hopes of the promoters, a failure. In the autumn of 1899 the second great wave of extravagant optimism in regard to industrial combinations was rapidly reaching its height. Then, too, in the present instance, an adjustment of actual rights was difficult. No fraud could be urged on either side. Yet the preferred shareholders held to the wording of their contract, Shylock-like demanding their accumulated dividends though there was nothing with which to pay them; and the common shareholders, never having received a cent in dividends, regarded the whole affair as a snare, and were unwilling to relinquish any of their nominal rights, even though the actual value of their holdings would clearly be increased. The investor in corporation stock, especially the small investor whose knowledge of the management is indirect, will always gauge the value of his property by nominal rights and legal fictions rather than actual economic value. No reorganization in the entire history of our railway and industrial finance, which involved a readjustment of interests, was ever regarded as fair by all. The most glaring defect of the plan lay in the fact that the capital liabilities were not reduced. With over $130,000,000

[1] Colgate v. U. S. Leather Co., Knapp Affidavit.

of outstanding securities the Company showed average net earnings from its formation to January 1, 1899, of approximately $2,675,000[1] per annum or about 2% on the total capital. Had the committee proposed to cancel altogether half of the common stock instead of giving it outright to the preferred stockholders, the plan would have conformed better to the conditions. It would have been simpler, too, as it would have involved a sacrifice on both sides instead of an attempt to balance one set of rights by another.

For some time after the failure of this plan nothing was done toward the readjustment of the financial affairs of the Company. A dividend of 6% was earned and regularly paid on the preferred stock. The accumulated unpaid dividends increased, therefore, at the rate of 2% annually. During the latter part of 1902 the management became interested in the reappraisal of certain large areas of hemlock bark lands. These timber forests were bought from the old leather interests early in 1893 at what was then a fair market valuation. During the following ten years the value of both timber and bark had increased considerably. It was natural, therefore, to suppose that the lands were worth more than when acquired.[2] A revaluation was accordingly made by certain executive officers and was reported to the Board of Directors on May 28, 1903. The Committee reported that the bark property was worth about $14,000,000 more[3] than the figures at which it was carried on the Company's books. This revaluation plays a considerable part in the subsequent financial history of the Company. About the same time the officers of the United States Leather Company caused to be incorporated the Central Pennsylvania Lumber Company, a very large majority of the stock of which — apparently all except Directors' qualifying shares — passed directly into the

[1] Including interest on debentures, an average of $2,676,804.

[2] The reason for this reappraisal was the desire on the part of the managers, who then controlled the preferred stock largely, to adjust the accumulated dividend claims on the basis of a hidden but unearned surplus. Preferred Stockholders' Circular, May 28, 1903. Also Colgate *v.* U. S. Leather Co., Hoyt affidavit, p. 14.

[3] $14,235,198.10. Colgate *v.* U. S. Leather Co., Plum, Additional affidavit, p. 7.

treasury of the Leather Company. This Lumber Company took over the timber but not the bark rights on the revalued bark lands. In payment for the timber the Lumber Company then issued to the subsidiary tanning companies $10,000,000 of first mortgage bonds. These bonds were transferred by the subsidiary companies to the treasury of the United States Leather Company — the holding company — in liquidation of dividend claims or claims for money advanced.

On the same date that the report upon the revaluation of the bark lands and the formation of the Lumber Company was received by the Board of Directors, that body issued a circular to the stockholders which embodied a new plan of reorganization. In this it was suggested that some of the surplus brought to light by the revaluation of the timber be used to liquidate the claims of the preferred stockholders to accumulated dividends by that time amounting to $37 per share. In detail the plan required the deposit of the preferred stock with the Morton Trust Company against negotiable certificates. The Trust thus created was to be administered by a self-constituted committee, drawn directly from the large holders of preferred stock who were then important on the directorate. It was to expire by limitation in ten years unless reconstituted by 80% of the holders of the certificates.[1] It could also be terminated on sixty days' notice by a majority of the certificate holders.[2] The objects of the trust, as explicitly defined in the Trust Agreement, were to ratify the issue of the $10,000,000 lumber bonds,[3] and to devise a plan whereby some of the surplus resulting from the revaluation could be divided among the preferred stockholders, in consideration of their claim to dividends in arrears.[4] The intent of the plan to use this surplus to meet the claims of the

[1] Preferred Stockholders' Agreement of 1903, Article xii, Par. 3.

[2] *Ibid.*, Par. 1.

[3] Preferred Stockholders' Agreement of 1903, Preamble.

[4] The original certificate of incorporation required the ratification of all issues of bonds or debentures by 80% of the outstanding preferred stock. Although the Lumber Bonds were not a direct obligation of the United States Leather Company, the management deemed it wise to obtain the assent of 80% of the holders of the preferred stock to their issue.

preferred shareholders was explicitly stated in Article III of the trust agreement, so that as late as 1903 the directors were of the opinion that the increase of assets due to the higher market price of timber could be regarded as net surplus legally applicable to the satisfaction of the claims of the preferred shareholders. The point is important because in the litigation which followed the successful reorganization of the Company the point was denied by some of these same men who had earlier made the proposal.

This plan failed, like the two preceding ones. Its adoption required a deposit of at least 80% of the outstanding preferred stock, — upwards of 500,000 shares. On December 23 the Committee announced the lapse of the plan, since only 243,728 shares had consented to the Agreement. The reasons for the failure of the plan of 1903 lay in the conditions under which it was proposed. In the broad purpose of rehabilitating the credit of the Company no possible fault could be found. The plan, unlike the preceding one, involved no balancing of rights between preferred and common shareholders. It demanded no pecuniary sacrifices, no reorganization proceedings in the broad sense of the term. Yet the trust created by the preferred stockholders was to be administered under most exacting conditions. Title to the stock was to pass to the Trust Company under an Agreement the actual workings of which were controlled absolutely by a small committee in the management of the Leather Company. Beneath the outward form of the Agreement there was involved the actual surrender of the rights of the preferred shareholders with no certain assurance that these rights would be protected by the trustee. Nor did the Agreement stipulate that the Morton Trust Company should obtain a settlement of all the dividends in arrears. It was merely required to pay over to the registered holders of the beneficiary certificates 6% per annum, and so much more, after deducting expenses, as the Leather Company saw fit to pay over to the trustee. The Agreement, owing to the phraseology of the original certificate of incorporation, required at the outset the assent of over 80% of the preferred stock; it could be maintained for ten years by the approval of 50%. The management, who were to operate the

Trust through their own committee could easily control this amount. In brief the plan had primarily in view the acquisition of control of the preferred stock through the medium of a voting trust. This was less emphasized than the intention of adjusting the accumulated dividends.

The managers, being large holders of preferred stock, were actively in favor of this Agreement. They believed confidently that the reorganization would go through. In view of this the President and four members of the Board of Directors acquired, at the instigation of counsel, on syndicate account, 50,000 shares of the common stock. It was the intention of the members of the syndicate to turn over the stock, at cost, to interests favorably inclined to the new Company, and thus constitute a voting trust which should control the United States Leather Company. Such a control, friendly to the management, was considered expedient as the outstanding common stock, of little market value, exceeded the issue of preferred stock. The syndicate acquired the stock during January, February, and March, 1903,[1] before the publication of the revaluation of the bark lands. As the Agreement failed of adoption the syndicate suffered a loss for over a year. It was finally able to liquidate its holdings during October and November, 1904, on the expectation of the consummation of the fourth and last plan of reorganization.

After the failure of this third plan of adjustment in December, 1903, nothing was done further until April, 1904, when Nathan Allen,[2] a large holder of preferred stock, conferred with Vice-President Healy of the United States Leather Company regarding the coöperation of Armour and Company, producers of green hides.[3] Allen had already had considerable dealings with Armour & Company. Some months later a meeting was arranged between P. A. Valentine, of Armour & Company, and

[1] Colgate v. U. S. Leather Co., Defendants' affidavit, pp. 16, 114, 120, 126, 132.

[2] Nathan Allen was a large competitive producer of harness leather in the west. He had acquired a considerable interest in the United States Leather Company, by purchases of its shares on the open market. Although not active in the management of the Company he was much interested in its welfare and on friendly terms with its officers.

[3] Colgate v. Leather Co., Hoyt affidavit, p. 31.

Vice-President Healy. This meeting took place in Chicago in the late summer and with it began the negotiations which ended finally in the reorganization of the United States Leather Company into the Central Leather Company.

From the very beginning the leather combination had been weak in its control over the market in which it bought its hides. It seemed clear that if the Chicago packers could be induced to coöperate in the management of the Company, a great and permanent trade advantage would be insured. The Armours had their price. At first they asked $9,000,000 [1] of stock in the reorganized Company, but "after serious and protracted discussion the amount of $6,200,000 was finally fixed." [2] This ample allotment to the Chicago packers was not considered a gift. On the contrary it was widely heralded that the Armours would sell their hides to the United States Leather Company on more favorable terms than they extended to other tanners. The good-will and the coöperation of the packers were supposed to have a pecuniary value. Yet the real advantage to the Leather Company arising from the coveted coöperation is problematical. The agreement between the Armours and the Committee of the Leather Company required that the former parties pay for the expenses of the reorganization. Considerable expense was involved in the underwriting, for the Armour interests agreed to acquire sufficient stock in the United States Leather Company to insure the consummation of the plan. Another large expense was a fee of $15,000 to each of the five members of the Committee of the management of the Leather Company with whom the plan was negotiated. Yet, and here is the weakest point in the whole agreement, the Armours did not agree to

[1] Colgate *v.* Leather Co., Defendants' affidavit, p. 115.

[2] It is believed by the writer from information derived from reliable but indirect sources that the amount first proposed by Valentine was ten million instead of nine as stated in the affidavit, and that the final agreement on $6,200,000—ten per cent of the outstanding common stock—was due to one of the Armour representatives who had charge of the sale of their hides. It was the plan of the Armour representatives before entering the conference, to begin their negotiations on the basis of a high figure and gradually work down in accordance with the attitude of the Leather Directors. Afterwards they expressed surprise that the leather interests acceded to so high a figure.

sell hides to the United States Leather Company on better terms than those extended to its competitors, nor did the Armours agree to retain their stock.[1] There was absolutely nothing in the agreement to prevent the Armours, once in command of the situation, from administering the Leather Company in the interest of their packing business. Should they fail in this, they could sell their stock on the open market and withdraw their coveted coöperation. Before the plan of reorganization was published, while negotiations were in progress with Vice-President Healy and others, the Armour interests bought 150,000 shares of the common stock of the United States Leather Company, ostensibly to vote for the resulting plan and thereby insure its acceptance. The common stock was then selling in the neighborhood of $10 a share. In the course of these negotiations the Armour interests stood out clearly in every particular for the interests of the common as against those of the preferred stock,[2] and the reorganization presently to be consummated was of manifest benefit to the common stock, since it would remove the burden of accumulated dividends on the preferred stock. When the plan was made public the price of the common stock rose to $15 and later $21 per share.

The final agreement between the various interests was framed in New York in the early part of December, 1904,[3] and the resulting plan of reorganization bore the date of December 17th. The circular, which announced the plan to the public gave certain specific reasons for its adoption. Among them were (1)

[1] Colgate *v.* Leather Co., Hoyt affidavit, pp. 32, 35.

[2] *Ibid.*, pp. 29, 31.

[3] The definite understanding between the parties was concluded early in November but was not made public until later. This is proved conclusively from the Valentine affidavit. On page 143, line 10, Valentine states "neither Mr. Armour nor I was the owner of or in any wise interested in a single share of the stock of said Company, either Common or Preferred, nor did either of us become such owner or so interested until after the general or structural features of the plan of December 17, 1904, had been practically agreed on with Messrs. Hoyt, Healy," etc. Later in the same affidavit (page 145, line 8) this same Valentine states that he and Mr. Armour "purchased, in the open market, during November and December, 1904, . . . 150,000 shares of Common Stock. . . ." Colgate *v.* Leather Co., Valentine affidavit. Also Hoyt affidavit, p. 42.

that the working balance originally obtained from the $6,000,000 debenture bonds was insufficient, and (2) that "the establishment of closer relations with interests with which this Company necessarily has large dealings and the vesting in them of substantial accounts of the securities of the Company, and especially of its common stock, will be a material benefit to the Company and to both classes of its stockholders."[1] To accomplish these purposes the Committee of the Directors proposed to form a new company that should acquire the physical assets of the United States Leather Company.[2] The securities of the United States Leather Company were to be exchanged for those of the new company on the following basis: For each share of the old preferred stock was to be given 50% of first mortgage 5% bonds, 50% of new 7% cumulative preferred stock and a bonus of 23½% of new common stock. Each share of old common stock was to receive only 30% of new common stock, — each ten shares of old stock being considered equivalent to three shares of new stock. The reorganized Company itself had $80,000,000 of stock, divided equally into 7% cumulative preferred stock and common stock. In addition it was proposed to authorize an issue of $45,000,000 of first mortgage bonds. The issue of United States Leather Company's debentures was allowed to remain undisturbed. The distribution of the capital items of the two Companies may be seen at a glance from the table given on the next page.

It will be observed that the fixed charges are reduced by an amount equivalent to 2% on the old preferred stock. Leaving aside the interest on the outstanding debentures, which remained the same for both corporations, the reorganized Company called for the payment of about $1,500,000 on the new bonds and $2,-200,000 on the new preferred stock. The total charges were therefore a little over $3,700,000, an amount exactly equal to 6% on the old preferred stock. The average net earnings of the old Leather Company, from its inception to the end of December,

[1] Circular to Stockholders of The United States Leather Company of December 17, 1904, Par. 4.

[2] *Ibid.* Outline of Plan, Sec. 2.

UNITED STATES LEATHER COMPANY — CENTRAL LEATHER COMPANY

	United States Leather Company					Central Leather Company								
							First Mortgage Bonds			Preferred Stock			Common Stock	
	Bonds	Fixed Charges	Preferred Stock	Contingent Charges	Common Stock	Underlying Bonds	Each Stockholder	Aggregate	Fixed Charges	Each Stockholder	Aggregate	Contingent Charges	Each Old Stockholder	Aggregate
	$	$	$	$	$	$	%	$	$	%	$	$	%	$
Debenture Bonds	5,280,000	316,800	....	....	....	5,280,000	...	....	316,800					
Preferred Stock	....	....	62,282,300	4,982,584	...	. .	50	31,141,150	1,557,057	50	31,141,150	2,179,880	23½	14,636,340
Common Stock	....	....	....	....	62,882,300	. . .	. . .	....	....	....	....	....	30	18,864,690
To the Armour interests for their coöperation and the expenses of the reorganization		....	. . .	.	. .		.	. .		. . .	.	. .	. . .	6,200,000
Total issued	5,280,000	316,800	62,282,300	4,982,584	62,882,300	5,280,000	....	31,141,150	1,873,857	....	31,141,150	2,179,880	...	39,701,030
Reserved in Treasury to retire Debentures, and to acquire other property	....	. . .	....	....	.	. .	. .	13,858,850		.	8,858,850	.	...	298,970
Total authorized	....	....	....	....	....	. . .	...	45,000,000	.	. .	40,000,000	....	. . .	40,000,000

SUMMARY

	Old	New	Change: Amount	Change: Percentage New to Old
Securities bearing Fixed Charges	$5,280,000	$36,421,150	+$31,141,150	690%
Securities bearing Fixed and Contingent Charges	67,562,300	67,562,300	.	100%
Total Securities	130,444,600	107,263,330	− 23,181,270	82%
Fixed Charges	316,800	1,873,857	+ 1,557,057	592%
Fixed and Contingent Charges	5,299,384	4,053,737	− 1,245,647	76%

1904, had been a little over $3,000,000.[1] The proposal of the reorganization was therefore far from conservative. One of the most important items in any plan of reorganization is the change in capitalization. Is the total capitalization increased or decreased while the actual assets remain unchanged? Counting the underlying debentures as the same in both cases (in round numbers $5,000,000) the capital liability of the old Company stood at $130,000,000, that of the new Company, including the bonus of common stock to the Armours but excluding the amounts reserved for "additional properties" and "general purposes," at $107,000,000. This, it will be observed, represents a slight reduction in capitalization, and if the $6,000,000 given to the Armours is still further subtracted the reduction is more marked. Considering, however, that the securities bearing charges remain essentially unchanged, and that the common stock, which alone is reduced in amount, was given originally as a bonus, the reduction in capitalization is not as significant as might at first sight appear. Furthermore one should observe that the United States Leather Company was capitalized during the earlier period of industrial promotion, when the issuing of bonds was seldom considered conservative. The new Company was burdened by over $30,000,000 of bonds carrying upwards of $1,500,000 in fixed charges, a failure to pay the interest on which might throw the Company into bankruptcy. The strength of the old Company, in its practical freedom from fixed charges, was sacrificed in order to reduce the contingent charges and obtain new working capital. Viewed in the perspective of conservative finance it is doubtful if the sacrifice was worth while. Yet in the minds of the officers of the Company the consummation of the plan of reorganization seemed likely to secure the advantages of a more liberal charter, the coveted coöperation of a powerful group of packers, the extinction of the claim to unpaid dividends and a consequent improvement in general credit, the reduction of capital charges, and the acquisition of better facilities for obtaining bank credit.

[1] *Supra*, p. 22.

Before attempting to estimate the inherent justice of the plan, one must consider the question of the status of the timber land surplus of the United States Leather Company. This surplus, it will be remembered, arose from an increased valuation placed upon the Company's large hemlock forests. The timber of these forests, but not the bark, had been sold to a subsidiary company and the increased value of the lands was represented partially by bonds of this concern in the treasury of the United States Leather Company. It was argued by the Directors and those who believed that the terms offered the preferred shareholders were just, that this revaluation surplus could not be used rightly for the adjustment of their accumulated dividends. The original contract between the corporation and its preferred shareholders stated that dividends should be paid only out of net earnings. Increase in the value of real property could not be construed as net earnings. Moreover, the revaluation was based on the assumption that the Leather Company was a "going concern," a contention which seemed to imply that the new value placed upon the lands was excessive if the property was to be sold in the open market. In opposition to these views those who considered the plan unfair to the holders of the preferred stock pointed out that timber representing the increase in value of the bark lands had been sold and the Leather Company had received merchantable securities in payment. These securities were, therefore, net earnings and could be rightfully used to liquidate the claims to unpaid dividends. To reinforce their position they reverted to the circular sent to the stockholders in May, 1903, in which the same Directors declared explicitly [1] that the surplus belonged to the preferred stockholders for the settlement of their dividend claims. The question is certainly an interesting one from the point of view of accountancy. Its solution would seem to depend, in the opinion of the present writer, upon the intent behind the sale of the timber to the subsidiary company. If this transfer actually represented

[1] "Whereas such surplus of the Leather Company might properly be distributed among the holders of its preferred stock. . . ." Preferred Stockholders' Agreement of 1903, Par. 10.

a *bona fide* sale of property without involving a corresponding diminution of capital assets, then the profits were certainly a part of the net profits of the business and could be used legitimately to reduce the outstanding obligations to the preferred shareholders. If, on the contrary, the formation of a subsidiary corporation involved only a legal fiction and the transfer of lumber to it indicated no *bona fide* sale, then the profits arising were certainly not net profits and could not be used to liquidate the claims of the preferred shareholders. The question, unfortunately, was not passed upon by the court,[1] when the whole reorganization came under its review.

The question of the fairness with which the preferred stockholders were treated is one of particular importance in this reorganization since the readjustment of capital was entirely voluntary on the part of the stockholders. It followed no legal failure nor was it suggested as the solution of financial difficulties which might lead to bankruptcy. It was based on grounds of general expediency alone, and no plan of financial readjustment can be permanently expedient which is not, at the same time, fair to all interests concerned. Setting aside the question of accountancy, as to whether or not the bark land surplus was strictly chargeable to the Company's profit and loss account, it would seem that the justice of the reorganization was defensible upon either of two lines of evidence, — the actual value of the property at issue or the market value of the various securities concerned in the reorganization. That is, the fairness of the reorganization can be tested by the equity or inventory value of the assets behind the preferred stock; or by the market value of the securities before and after the consummation of the reorganization.

[1] Two of the leading cases regarding the legal status of a surplus in excess of a stock liability are Williams *v.* Western Union Telegraph Co. (93 *N.Y.* 162) and Roberts *v.* Roberts-Wicks Co. (184 *N. Y.* 257). In the former Earl, J., states that when the property of a corporation exceeds its capital stock "such surplus, in a strict legal sense, is not a portion of its capital and is always regarded as surplus profits" (p. 188). And in the second case, Gray, J., said "When the property of a corporation has accumulated in excess of its chartered capital, the excess may be regarded and dealt with as constituting a surplus of profits" (p. 266).

When we consider the former of these two questions, we must remember that at the time the tanneries and bark lands were acquired in 1893 there was little doubt in the minds of the tanners but that they were paid for in preferred stock on the basis of a fair valuation. The $6,000,000 of debenture bonds were issued for money, the bankers taking their commission in common stock. This money was invested directly in the business. We may therefore say, for the purposes of this accounting, that the properties of the Leather Company were, on a fair market valuation, originally worth the face value of the preferred stock and the debentures, $68,283,300.[1] On January 1, 1905, a fair date for comparison, the United States Leather Company had acquired a surplus from the net earnings of $3,964,813, and a surplus from the revaluation of the bark lands of $14,235,198, making a total surplus of $18,200,011. The small surplus from net earnings had been largely invested in the properties, so that on January 1, 1905, a fair valuation of the physical properties of the Leather Company would be about $86,483,311, and from this subtracting the debentures, — on January 1, 1905, $5,280,-000, — it appears that the preferred stock of $62,283,300 was represented by actual physical property to the value of about $81,203,311. The surplus to the preferred shareholders was therefore about $18,920,011. This represented $30.38 a share. The accumulated unpaid dividends amounted then to 41% so that it is quite right to say that the claim for unpaid dividends was worth about seventy-five cents on the dollar. For this $30.38 per share of actual property the preferred shareholders were asked to accept 23½% in new common stock. On the basis of the market quotation of $15 per share for the old common stock this allowance was worth $11.75. In other words, for a legal claim to $41 per share and an actual inventory surplus of $30.38 per share the preferred holders were asked to accept securities the market value of which was $11.75.[2] From such a statement of the case it would seem that the reorganization

[1] As a going business. Tangible assets worth at least $60,000,000.

[2] These estimates can be summarized in the following table. They assume that an adequate depreciation charge was made each year. This assumption is borne out by the fact that the Company charged its capital account with the bark it

was unfair to the owners of the preferred stock. And if we, further, turn to the equity value of this allowance of common stock the story is not very different. The new common stock would have an equity value, if the reasoning suggested in the preceding paragraph is approximately correct, of about $18,920,-011 of actual property. Dividing the equity value by the par value proposed to be issued, we reach the conclusion that each share of the new common stock had a property value back of it of about $48. The preferred stockholders were to receive 23½% of their holdings in this common stock in consideration of their claim to unpaid dividends. In property value this 23½% of common stock had an equity back of it of only about $11. From these figures it appears again that the plan of reorganization was unfair to the preferred shareholders.[1]

But there were other considerations than the mere adjustment of inventory values. If we turn to the market prices of the preferred shares as affected by the reorganization, the story presents another side. The rehabilitation of the Company's finances was undoubtedly of general advantage to the credit of the corporation. This fact is clearly shown by the improvement in the market quotations of its securities. During the first six months

consumed, while it maintained and improved its tanneries out of earnings. The bonds were being retired by a small sinking fund.

Equity Value of Preferred Stock Claim

Surplus from net earnings May 1, 1893 to January 1, 1905	$3,964,813	
Surplus — Revaluation of Bark	14,235,198	
Total surplus, January 1, 1905		$18,200,011
Preferred Stock	62,283,300	
Debentures	6,000,000	
Original Property Investment		68,283,300
Total Physical Property, January 1, 1905		86,483,311
Debentures Outstanding	5,280,000	
Equity to Preferred Stock	81,203,311	
Surplus to Preferred Stock		18,920,011
Surplus per share of Preferred Stock		30.38
Accumulated Unpaid Dividends		41.08
Percentage of Actual Property to Preferred Claim		74%
Market value of the 23½% new stock offered (on basis of $15 for old stock)		$11.75

[1] The computation is based on the following presumptions:

Equity to New Common Stock (From preceding note.)	$18,920,011	
Common Stock outstanding against this	39,701,030	
Equity value per share		$48
Equity value of 23½% offered		11.28

of the year 1904, before the publication of any plan of reorganization on the lines sketched above, the preferred stock had an average market valuation of $78 a share. During the time the plan was being worked out, the stock rose steadily in value and soon after the plan was made public it was quoted at $106 a share. During the first half of 1905 the market price of the stock averaged $108 a share, and during the last half $115 a share. It is very clear, therefore, in spite of the estimates outlined in the preceding paragraph, based as they were upon inventory value rather than on market quotations, that the reorganization was of manifest pecuniary benefit to the preferred shareholders. Irrespective of any inventory value, the plan would seem to be fair to the preferred stockholders, since the market value of their shares increased by an amount approximately equal to the unpaid claims to dividends. These two lines of reasoning bring into clear contrast the two different points of view about which all estimates of the justice of a voluntary reorganization center. According to a computation based on inventory values the preferred shareholders were unfairly treated; but if the estimate is based on the enhancement of the value of their securities in the open market, because of the supposed advantages of the reorganization, one must presume that they were treated with the utmost liberality. It is a question of the same order as is frequently presented in financial readjustments, one that emphasizes the importance of intangible factors in determining the value of corporate securities.

The plan of reorganization just sketched did not meet with immediate and unqualified approval. Aside from the grumblings of both preferred and common stockholders,[1] — grumblings that always appear no matter how fair any plan may be, — the two points which called for the most general condemnation were the gift of over $6,000,000 of common stock to the Armours and the slight consideration given to the accumulated dividend claim of the preferred shareholders. However, by

[1] For example, published letters of dissatisfied shareholders. See letter to *Boston Herald*, dated December 17, 1904; *New York Evening Herald*, dated December 19, 1904.

February 15, 1905, 413,143 shares of the preferred, and 429,997 [1] of the common stock had been deposited with the Central Trust Company of New York, and on the following day the Committee announced that the plan was operative.[2] On April 12, 1905, the Central Leather Company was incorporated under the Corporation Act of New Jersey of 1893,[3] which permitted of a more liberal charter than the old Corporation Act of 1875, under which the United States Leather Company had been incorporated. Soon thereafter, about May 23d, the interim certificates of the Central Trust Company were exchanged for the bonds and stocks of the Central Leather Company in accordance with a plan of exchange outlined in an earlier paragraph.[4]

In the years immediately following the reorganization, the two companies were in a legal sense separate concerns. This separation, however, was little more than a legal fiction. The directors of the United States Leather Company were directors in the new Central Leather Company. The two companies had identical offices and the same places of business. Although at first merely a holding corporation, the Central Leather Company immediately began to acquire and to operate competing tanneries. They obtained the tanneries of L. Beebe and Sons, N. R. Allen's Sons Co., Cover and Drayton, V. A. Wallin and Co., and certain smaller interests. For these additional properties payment was made partly in treasury bonds and stocks and partly by the sale of these same securities. The Central Leather Company represented, therefore, almost from its inception an interesting example of an operating and a holding company in one. Beginning July 1, 1905, the full dividends

[1] Colgate *v.* Leather Co., Valentine affidavit, p. 146.

[2] Two days later the interim certificates were listed on the New York Stock Exchange.

[3] Act of March 8, 1893. *P. L.* of 1893, p. 121.

[4] The number of sales of the United States Leather Company stock diminished to insignificance and those of the Central Leather Company assumed some appearance of speculative activity. A large amount of the floating supply of the old stock was acquired in the interests of the reorganization and by the close of 1906, 575,180 shares of the preferred, or 92% of the total issue, and 614,828 shares of the common stock, or 97% of the total issue, were in the control of the new Company. Colgate *v.* Leather Co., Hammond affidavit, "Exhibit A," p. 146.

were paid on the preferred stock of the Central Leather Company. The few outstanding stockholders of the United States Leather Company apparently had no alternative other than to accede to the terms of exchange still proffered them or to sell their stock in the market to agents of the management who stood ready to buy it at a liberal price. With only a small minority interest of the United States Leather Company outstanding the management sought to simplify the organization by a merger of the two corporations. On December 18, 1906, official notices were sent to the stockholders of both companies stating that there would be stockholders' meetings of both companies on January 16, 1907. The immediate purpose of these was stated as the "adoption or rejection of a joint agreement, dated December 8, 1906, entered into by the Directors respectively of the United States Leather Company and the Central Leather Company for the merger and consolidation of the two corporations on the terms and conditions of said Agreement set forth and in accordance with the statutes of New Jersey."[1] The Agreement mentioned was merely the Agreement between identical directors and officers of the two companies to merge. It offered the outstanding stockholders of the old United States Leather Company the terms of exchange by which the Central Leather Company had originally acquired the majority of the stock.

In the notice to the stockholders reference was made to the statutes of New Jersey. At the time in question, 1907, these required only a two-thirds vote of the stockholders of two corporations to ratify a merger. Since the Central Leather Company then controlled over 95% of the United States Company's stock the plan had apparently been actually accomplished, except for legal formalities. But the "best laid schemes" of even astute corporation lawyers "gang aft agley." A firm of New York bankers, James B. Colgate and Company, entered into an agreement with a number of the outstanding minority shareholders of the old Leather Company to contest the merger in the hope of compelling the Company's management to buy the minority interest at a higher price than that accorded the

[1] Notice of special meeting of stockholders, dated December 18, 1906.

majority of the stock. Accordingly two suits were brought with that object in view on January 12th, just four days before the special meeting at which it was proposed to ratify the agreement of merger. It is beside our present purpose to review the litigation in any detail. We may note in passing, however, the interesting question concerning the powers of stockholders derived from the statutes under which a corporation's charter is granted; do the statute rights of the original shareholders lapse when they transfer their stock to other persons? This somewhat academic query assumed importance because the corporation laws of New Jersey were changed less than a month after the formation of the United States Leather Company and the rights of stockholders covering the merger of corporations were different according as they were derived from the earlier or the later statute. The courts did not render a final decision on this question.

The subsequent steps of the reorganization can be told briefly. Vice-Chancellor Emory, who delivered the opinion of the lower court in the application for an injunction *pendente lite*, overruled most of the contentions of the Colgate complainants. He held, however, that the merger violated the rights of the preferred stockholders of the United States Company in that it required them to accept the securities of the new Central Leather Company in lieu of their claim for unpaid dividends. With this decision in mind, the directors of the two corporations then presented to the stockholders a modified agreement under date of October 10, 1907, permitting the dissenting minority stockholders to retain "any lawful right . . . to receive any dividends accrued and unpaid." The lower court then modified the preliminary injunction to the extent of allowing this agreement to be submitted to the stockholders of the companies for approval. From this decision of the lower court the original complainants, Colgate and others, appealed to the Court of Errors and Appeals. The case was argued in the higher court June 24, 1908, and a decision was rendered by Chancellor Pitney the first of March following. The court expressed itself very forcibly against the merger on the ground of the difference between the

charters of the two companies. The original United States Leather Company, organized early in 1893, obtained merely an old-fashioned charter which permitted it to conduct the leather business, but said nothing about running railroads or doing a hundred other things which find their way into modern corporation charters. The lawyers of the Central Leather Company obtained for their clients a typical New Jersey charter based on the Corporation Law of 1893 which permitted the corporation to do anything outside the state of New Jersey that it saw fit to do, — for instance, to operate railroads. The statutes dealing with the merger of corporations, even those connected with the Corporation Act of 1893, required that the two corporations to be merged should be organized for the purpose of carrying on businesses "of the same or a similar nature." [1] Yet it should be remarked that the old corporation operated railroads, even though nothing to that effect was mentioned in the original charter. It may be inferred that the case was decided merely on technical grounds, and that the important and essential points in the controversy were left undecided.

On the announcement of this decision a stockholders' meeting was called to modify the charter of the Central Leather Company so that the charters of the two companies should more nearly agree. This was done on August 19, 1909. Meanwhile rumors of settlement out of court became current in banking circles. It was pointed out, rightly perhaps, that the general opinion of the higher court, aside from the difference in charters, was unfavorable to the proposed merger. This being so, the leather companies would do well to "settle" with the minority stockholders rather than risk another hearing. On September 23, 1909, the Colgate suit was withdrawn and the terms of settlement were made public a few days later. An offer was made by the Central Leather Company to the minority holders of the old United States Leather Company's stock which embodied an alternative. The stockholders could either accept for each share of old preferred stock $50 in first mortgage bonds, $55 of the Central Leather Company preferred stock taken at

[1] Act of March 8, 1893. *P. L.* of 1893, p. 121.

110, and $25 in cash, or else $50 in bonds, $50 in preferred stock, 23½% in common stock, and $10 in cash. This second offer was identical with the original offer in the plan of reorganization with the addition of a *bonus* of $10 a share. On a basis of market values there was little to choose between these two offers and one or the other was almost immediately accepted by practically all the remaining stockholders of the United States Leather Company.[1]

Although the contestants, Colgate and others, seemed to be fighting for the rights of a small minority, a large part of those who joined the suit were actuated by no such lofty ideals of abstract justice. Many of them acquired their stock long after the plan of reorganization was made public and some even after the suit had passed through the preliminary stages of trial. These men entered the contest with no purpose of defending rights already existent. They had a speculative interest only. Reduced to its simplest terms they believed they were in a position, by restraining the merger, to compel the management to offer exorbitant terms of settlement. All reorganization proceedings are impeded by the horde of gamblers who stand ready to buy, on a speculative basis, almost any security of doubtful value and then to clamor loudly for the abstract justice of their rights.[2]

It is not difficult to summarize the history and final reorganization of the United States Leather Company. Conceived originally at a most unfortunate time the combination had to face, at the very outset, the most trying period of the last thirty years. It operated in a business where the burden of a long depression and falling prices was particularly heavy. Had the

[1] The United States Leather Company, as a corporation, is still maintained with a nominal capitalization of $100,000. It is only a selling company. During the comparatively long period of the existence of the old company the name, The United States Leather Company, became widely known among the buyers of leather and its prestige was high.

[2] See the Hill affidavit in the Colgate suit, where the holdings of the complainants are given in detail. A large part, perhaps even a majority, of these holdings were acquired after February 15, 1905, after the reorganization was announced. E. C. Potter and Co., J. J. Dantzig, H. Feuchtwanger owned no stock until after the plan had been declared operative. These contestants were active in their protestations.

Company been heavily capitalized with bonds instead of preferred stock it would have succumbed. But since the capital charges were contingent, they could be postponed. As a result the unpaid dividends began to accumulate during the first year of the Company's history and acted as a burden during its entire existence. The Company did not suffer from the administration of inferior men. The first President of the United States Leather Company, Mr. Procter, was said to have been the ablest man in the leather business. But it is improbable that there exist men of sufficient business ability to manage a large tanning business producing upwards of $50,000,000 worth of leather a year with the same skill that the man of ordinary endowments could manage a small tannery. During the first few years the Company felt no need of additional working capital as is shown by the fact that two-fifths of the issue of $10,000,000 of debenture bonds were never sold. But beginning with the trade expansion which set in about 1899 this need began to be felt. So that in the successful reorganization of the Company the provisions for an ampler working capital were quite as important as the relief from the burden of accumulated dividend charges. The reorganization turned on the consent of the preferred stockholders to suffer a reduction in income and the common stockholders a reduction in the par value of their security. As a result both the capital charges and the capitalization were reduced. In these respects the reorganization is typical of most industrial reorganizations and in contrast to most railroad reorganizations. It is its simplicity that makes the history of the United States Leather Company significant for the general study of industrial finance.

CHAPTER III

THE STARCH CONSOLIDATIONS

Early history of the starch industry, 49; promotion of the National Starch Manufacturing Company, 52; original schedules, 55; value of the National Starch Manufacturing Company's property, 57; early history, 58; competition from Duryea & Co., 59; promotion of the United Starch Company, 60; National Starch Company Syndicate, 63; reorganization of National Starch Manufacturing Company, 64; value of property of the National Starch Company, 68; failure of the National Starch Company, 69.

CHRONOLOGICAL SUMMARY

1844. Establishment of the corn starch industry.
1880. Beginning of period of over-production and excessive competition.
1889. Organization of the Cumberland Investment and Security Company.
1890. Promotion of the National Starch Manufacturing Company.
1895. Beginning of Duryea and Company's competition.
1899. Promotion of the United Starch Company.
1900. Reorganization of the National Starch Manufacturing Company and promotion of the National Starch Company.

THE earliest promotion with which this book is concerned, in which a party entirely outside of the industry purchased many small plants in various parts of the country, occurred in the starch industry. Because this promotion illustrates well the character of the combination movement before 1890, it is of advantage to describe it in some detail. Moreover its subsequent history was important. The successor to the first starch combination was finally merged with the Glucose Sugar Refining Company, so that a complete narrative of the successive corporate reorganizations of the original Company involves the history of the glucose consolidations treated in the succeeding chapter.

The preparation of starch from the wheat is of extreme antiquity.[1] Numerous wheat starch factories existed in the United States before the Revolutionary War, and the wheat branch of the industry is still maintained to a limited extent. During

[1] First description by Dioscorides in the middle of first century. G. B. Frankforter, XIII *Proc. Cong. Applied Chem.* 1912, 133.

all the early period, the method of preparation of the starch was to allow a mixture of grain and water to ferment for a period of several weeks, until the destructive decomposition of the germ and nitrogenous matter had released the starch granules. Not until the last century was any important change made in this method. In 1840,[1] an Englishman, Orlando Jones, patented an improved process whereby an alkali was employed in the recovery of the starch granules. This process shortened the period of manufacture, and enabled the starch maker to obtain a larger yield. The Orlando Jones invention was patented for the United States in 1841,[2] and may be regarded as the basic patent for the present industry.[3] In 1844, Colgate and Company, who had been manufacturing wheat starch in their Jersey City factory, began to apply the Orlando Jones process to corn.[4] The experiment proved satisfactory, and was subsequently adopted by Julius J. Wood and Charles Colgate at their wheat factory in Columbus, Ohio.[5] Subsequently, the Colgates ceased to manufacture corn starch at their Jersey City plant, so that, at the time of the formation of the National Starch Manufacturing Company in 1890, the Wood plant at Columbus was the oldest corn starch manufactory operating in the United States. In the employ of the Colgates at their New Jersey factory was an Englishman by the name of Thomas Kingsford. In

[1] English patent granted April 30, 1840.

[2] March 12, 1841, No. 2000. A very exhaustive description of the Orlando Jones alkali process is to be found in the *Scientific American*, March 4, 1854. IX *Scientific American*, 194.

[3] This patent was assigned by J. T. Jones, executor for Orlando Jones, to two New York attorneys (September 19, 1844; Liber C1, page 79), who in turn assigned territory to various early manufacturers. It is important to note that every manufacturer of corn starch has used the Jones process or specific modifications of it.

[4] Letter dated February 1, 1844, of Charles Colgate. Investigations in the early books of Colgate and Company indicated that they began to purchase considerable amounts of corn for making starch after June 1, 1844. The attorney for the Colgates obtained rights under the Orlando Jones patent in 1845. (Assignment, Liber C1, p. 83.) They had, apparently, been using it before.

[5] Letter of Henry R. Wood, dated March 4, 1913. The rights under the Orlando Jones patent were not acquired by Wood until January 29, 1848. Liber P1, p. 407.

1848, he obtained rights under the Orlando Jones patent [1] and established a small corn starch factory at Oswego, New York.[2] About 1852, Hiram Duryea, then a young man, became interested in the corn starch industry, and experimented on the Orlando Jones process with a view of increasing the yield of starch per bushel of corn. His experiments were successful.[3] In 1855, he and his brothers established a corn starch factory at Glen Cove, Long Island, which in due course of time became the largest corn starch plant in the United States.

In the succeeding years, the corn starch industry grew by leaps and bounds until, by 1880, the annual consumption of the country was estimated at about 211,000,000 pounds while the productive capacity of the country had reached approximately 230,000,000 pounds.[4] Corn starch was being used for cloth sizing, for the manufacture of certain candies, for laundry purposes, and the preparation of desserts. Although the greater quantity of starch was sold in bulk for use in manufacturing industries, there was the larger margin of profit in the sale of "trade-mark" box starches for domestic consumption. Owing

[1] Assignment for "County of Oswego," July 21, 1848 (Liber R1, p. 333), to Thomas Kingsford.

[2] It has been stated frequently that Kingsford was the first corn starch manufacturer, and that the preparation of starch from corn was due to his experiments. (So stated, for example, by Dr. H. C. Humphrey before the Eighth International Congress of Applied Chemistry. XIII *Proc. Cong. Applied Chem.* 1912, 189.) This is not true. A research made into the original records of Colgate and Company shows that they were making starch in 1844 from corn and that Kingsford was an employee at their factory. Furthermore the specific assignment of rights under the Orlando Jones patent indicates that the process employed in Kingsford's Oswego factory was at most a modification of the Jones process, known and practised before. Kingsford's factory was not taken into the first consolidation, but was the most important constituent of the second combination formed in 1899. See p. 61.

[3] The improvement of a round cistern with toothed rake was invented by Hendrick V. Duryea, father of Hiram Duryea. Letters patent, 12,846. Dated May 8, 1855.

[4] Estimates of statistician for Glen Cove Manufacturing Company. His figures were "Annual consumption of country, 211,601,000 pounds; annual capacity of factories, 228,810,000 pounds. Of the total capacity the Glen Cove Manufacturing Company had 65,250,000 pounds, based on a 12-hour run. Latterly its plants were running twenty-two hours.

to the over-production, competition of a most severe character developed in both the bulk and domestic box starch branches of the industry. In the former it led to low prices which frequently fell below the cost of production and in the latter to heavy advertising and selling expenses to maintain the popularity of any special brand. These conditions of severe competition were further enhanced in the decade from 1880 to 1890 by an increase of production in the western field of poorer grades of starch, and a drastic cutting of prices by the small producers struggling for vantage ground without the support of an established trademark. Wm. F. Piel, Jr., first Vice-President and later the President of the National Starch Manufacturing Company, thus characterized the starch trade before 1890. "There had been among the different plants very severe competition for a number of years. Very many of them were working at less than their full capacity — in many cases producing about half of their capacity. Some half dozen of them had been closed entirely; some were in the hands of receivers. The best ones were making some money, but not much. In this period of severe competition the poorer plants, feeling the necessity of realizing rapidly on their products, were cutting prices very badly — in many cases down to below the cost of production." [1] Piel had reference to the condition of the western manufacturers, of whom he was one, for both the Duryea and Kingsford plants in New York State had been able, through the excellence of their product and the reputation of their brands, to maintain a level of prices which yielded a fair margin of profit. He is perfectly correct, however, in his statement that at the time of the organization of the National Starch Manufacturing Company, "the producing capacity of all the plants together was considerably beyond the need of the market at remunerative rates." [2]

He also testified before the Industrial Commission that "ever since the year 1882 efforts had been made in the starch business to form some kind of an organization that should be able to regulate the supply, but without success, owing chiefly

[1] XIII *R. I. C.* 672.
[2] *Ibid.*

to the jealousies among the individual manufacturers." Again Piel's reference seems to have been to the western manufacturers, for it has been impossible to find any evidence of an attempt to form a combination before 1889 which was intended to include Duryea's Glen Cove and Kingsford's Oswego plants. As the former alone produced upwards of 30% of the starch manufactured in this country, it is clear that no organization would be successful which did not include at least these two eastern manufacturers. In 1889 a promoter,[1] whose attention had been called to the starch industry because of the success of the Glen Cove Manufacturing Company, organized the Cumberland Investment and Security Company for the express purpose of acquiring options on various starch plants with a view of forming a large industrial combination. A general plan of amalgamation was arranged at a meeting in Cincinnati which was attended by a large number of the starch producers. The details of this we propose to discuss presently. It is interesting to note, however, that no general pooling agreements existed in the starch industry before the formation of the first starch combination and that this was formed as a corporation and not as a trust. The absence of the pooling and the trust forms of organization, prior to the formation of the corporation, is unusual in the history of an industrial combination promoted before 1891.

The promoter secured an option on twenty starch manufacturing plants situated in various parts of the country. The options stipulated that the vendors receive 25% of the value of their mills in actual money and the other 75% in securities of the National Starch Manufacturing Company.[2] The proportional allotment of securities was exactly the same for all the manufacturers. Of the 75% paid in securities, 45% of the amount was to be paid in bonds, 30% in first preferred stock, and 25% in second preferred stock. Another and simpler way of stating the same thing would be to say that the manufacturers received 25% in money, 33¾% in bonds, 22½% in first

[1] Chester W. Chapin. Mr. Chapin had been successful in several promotions. In this one he was associated with J. K. O. Sherwood, a broker.

[2] Option Agreement, dated January 30, 1890.

preferred stock and 18¾% in second preferred stock of the appraised value of their plants. In addition each manufacturer received a bonus of common stock of the National Starch Manufacturing Company amounting to 27½% of his price.[1] The working capital was inventoried and paid for in money. The promoter, through the Cumberland Investment and Security Company, of which he was President, furnished $1,545,750 to make the necessary money payments on the purchase of the plants. In return he received an equivalent in bonds and preferred stocks and an equal bonus of common stock.

Bonds	$695,587	(45% of money furnished)
First Preferred Stock	463,725	(30% of money furnished)
Second Preferred Stock	386,437	(25% of money furnished)
Common Stock	1,545,750	(100% of money furnished)

The money required to provide for the working capital, so that the Company might commence (computed as 20% of the value of the plant), was underwritten by the promoters on the same terms. This involved the underwriting of $1,236,600, for which

[1] The somewhat complicated conditions of stock issue were summarized as follows in the original option agreement between the Cumberland Investment and Security Company and eighteen of the vendors, dated January 31, 1890.—Section 5.

5th.—Each of the parties of the second part shall receive as Consideration for the conveyance of their plants, patents, trade-marks, good-will, etc., as aforesaid, the price named in their respective options with said Chapin, which price shall be paid as follows to wit: One-fourth thereof in cash, forty-five per cent of the remaining seventy-five per cent in said first mortgage bonds, thirty per cent of the remaining seventy-five per cent in said first preferred stock and twenty-five per cent of the remaining seventy-five per cent in said second preferred stock, and they also receive, in addition to the said bonds and preferred stock, common stock to the amount of thirty and three-eights per cent of the bonds and to the amount of thirty-five per cent of the first preferred stock and to the amount of fifty per cent of the second preferred stock to which they may be entitled as above.

6th.—Said Cumberland Company shall, on or before April 12th, 1890, pay to said Manhattan Trust Company the money necessary to meet the foregoing cash payments provided to be made to the parties of the second part and upon payment to the said Manhattan Trust Company of said money within said time and the payment and delivery by the said Manhattan Trust Company to the parties of the second part of the monies and securities hereinbefore stipulated to be paid and delivered to them, the said Manhattan Trust Company shall deliver to the said Cumberland Company, or other party making such payments, bonds and preferred shares equal in amount to the cash so paid, in the proportion of

service the promoters received nothing outright.[1] During the first two years of the National Manufacturing Company's existence, when the men behind the promoters were marketing the securities, the bonds sold for their par value; the first preferred stock averaged $105 a share in market price, the second preferred stock $109 a share, and the common stock $43 a share. On the basis of actual money values, then, the compensation of the promoters amounted to $722,677.[2]

The National Starch Manufacturing Company was incorporated under the laws of Kentucky, February, 1890. The Company acquired the plants and inventoried merchandise of twenty starch factories and issued in exchange a total of $12,353,900 in securities.[3]

forty-five per cent of bonds, thirty per cent of first preferred stock and twenty-five per cent of second preferred stock, and said Trust Company shall also deliver to the party making such payment, in addition to said bonds and preferred stock, Common stock equal to $\frac{2,799,875}{4,000,000}$ of said cash sum so paid * and shall also deliver to said National Manufacturing Company the deeds and abstracts of title deposited with it by the parties of the second part, but if the said Cumberland Company shall fail to pay to said Manhattan Trust Company the money as aforesaid stipulated to be paid by said Cumberland Company to said Manhattan Trust Company and within the time stipulated said deeds and abstracts and options shall be returned to the several parties of the second part, and this contract and all options shall thereupon be void as to all parties hereto. — Option Agreement, January 31, 1890. Section 6.

[1] The original plan, as evidenced by the option agreement of January 31, 1890 (article 7), contemplated the payment in cash for the inventoried working capital. The promoters agreed to furnish the cash on the same terms as they had furnished the purchase money for the plants. As an actual matter of fact the vendors took securities, with the 100 % bonus in common stock, for their working capital instead of cash. (The present writer has checked the names in which all the original certificates of stock, given for working capital, were issued. In practically every instance the certificates issued for working capital were issued to the same parties as those for the plants, and for proportionate amounts.)

[2] Owing to the difficulty that the student of economics finds in getting at the exact terms under which an early combination was promoted it seemed profitable to reprint the original schedule employed in acquiring the plants. The explanatory notes at the bottom of the table were not on the original schedule and are added here merely to complete the account. For memoranda purposes the daily grinding capacity of the plants is added at the side. For table, see attached chart.

[3] The original schedules call for slightly different amounts. These schedules were copied on the New York Stock Exchange Listing Application (A-877). Bonds,

* The common stock bonus was afterward increased to 100% of the cash furnished. The common stock authorized was increased from $4,000,000 to $5,000,000.

	Authorized	Issued	Rate	Fixed Charges
Bonds	$4,500,000	$3,837,000	6 %	$230,220
First Preferred Stock	3,000,000	2,219,400	8 %	177,552
Second Preferred Stock	2,500,000	1,846,800	12 %	221,616
Common Stock	5,000,000	4,450,700	....	....
Totals	$15,000,000	$12,353,900		$629,388

Of these plants that of the Duryea Glen Cove Manufacturing Company was distinctly the most valuable. It was the largest corn starch factory in the United States and produced upwards of 25 % of the starch made in the country besides a considerable quantity of glucose. It was, however, poorly located for competition with the Western manufacturers. The rest of the plants were relatively small. Altogether the National Starch Manufacturing Company had a rated daily capacity of 25,800 and a merchantable capacity of approximately 20,500 bushels of corn. This represented an annual yield of starch amounting to 200,000,000 pounds [1] or about 70 % [2] of the output of all the factories of the country. We can obtain an estimate of the actual value of the property acquired by the National Starch Manufacturing Company only through indirect evidence. The plants alone were assumed, on the basis of the money paid for them, to have a value of $6,183,000. At the time they had a remunerative capacity of about 20,000 bushels of corn a day. Thoroughly equipped up to date starch mills, making use of the alkali process with Duryea's cistern and rake equipment, could have been

$3,338,820; F. P., $2,225,880; S. P., $1,854,900; common, $4,482,771. Less amounts of stocks were issued than originally contemplated, as the working capital of two small factories was paid for from the treasury of the National Starch Company. Additional bonds were probably issued to obtain more working capital.

[1] Computed on a basis of 20,000 bushels of corn a day, producing between 30 and 34 pounds of starch to the bushel. In the listing application, New York Stock Exchange, it was said "The properties owned by the National Company have a capacity of from 230 to 240 million pounds and are now producing rising 200,000,000 pounds of starch yearly." Listing Application, New York Exchange, A-877, June 6, 1890.

[2] In his affidavit Wm. F. Piel, Jr., estimated the percentage of control as 65 %. (XIII *R. I. C.* 673.) It is believed that the larger percentage is more correct. Piel under-estimated the Duryea plant which had duplicate apparatus enabling it to operate nights.

built at the time for approximately $2,000,000. A number of the plants were so antiquated and so expensive to operate that they were immediately closed. Mr. Piel admitted later that, had the better equipped manufacturers known of the condition of the poorer ones, they would never have entered the combination.[1] On the other hand the real estate value of several of the pieces of property was far greater than the mere manufacturing value of the plants.[2] All things considered it is probably fair to believe that the plants had an actual value of about $2,500,000. It was believed by the promoters at the time that the plants were worth at least a third more than the total par value of the bonds.[3] The working capital had an inventoried value of $1,236,600. The actual property acquired by the National Starch Manufacturing Company was therefore worth approximately $3,750,000. Against this the Company issued $3,837,000 in bonds and $8,500,000 of stock, carrying $230,220 in fixed charges and $400,000 in contingent charges. Had the Company been able to pay all the fixed and contingent charges on its bonds and preferred stocks, without any dividend on the common stock, it must earn approximately 17% on the actual property investment. It

[1] XIII *R. I. C.* 672.

[2] For example the National Starch Manufacturing Company acquired from the Duryeas valuable New York real estate fronting on South, Water, and Montgomery streets in addition to the starch factories at Glen Cove, L. I. Articles of Agreement for sale of Glen Cove Manufacturing Company, dated March 24, 1890.

[3] NEW YORK, June 5, 1890.

MR. HIRAM DURYEA, *President*,

DEAR SIR:

In response to your enquiry, I would say that the Cumberland Investment and Security Co. in acquiring the several plants, contracts, it assigned to the National Starch Mfg. Co. — embracing all of the factories now owned by the National Starch Mfg. Co. — the real estate was valued by conservative appraisers, and the bonds ($4,500,000) issued to secure the mortgage placed upon said real estate by the National Starch Mfg. Co. do not exceed seventy-five per cent of the appraised value.

CHESTER W. CHAPIN, *Prest.*
Cumberland Investment and Security Company.

This letter is incorporated because it forms the basis of Mr. Duryea's statement to the listing committee of the New York Stock Exchange (Application A-877, June 6, 1890); also the statement in the *Commercial and Financial Chronicle* to the same effect.

should be remembered, however, that the trade-marks of the various companies acquired by the National Starch Manufacturing Company were of great value. In fact, from the point of view of earning capacity, it could very well be contended that several of these trade-marks were even more valuable than the factory property where the starches were produced.[1]

The first Board of Directors consisted of twenty-one members, seven of whom were representatives of the promoters and fourteen of the old starch interests. Hiram Duryea was chosen President. His policy was to restrict the output to such proportions that the Company should be able to dispose of its product at a profit. He tried not to antagonize the manufacturers outside of the combination by a destructive price policy. The prices of starch were successfully held at high levels and the first year of the Company's history showed substantial earnings so that the Directors were able to pay the interest, sinking fund and preferred dividend charges, — (amounting in all to $736,824) and in addition a dividend of 1% on the common stock. The total payments on the securities amounted to $914,852. This was the most successful year in the life of the Company.

One of the greatest weaknesses of industrial combinations is the difficulty they meet of holding their most efficient officers to the detailed administration of the Company's business. One of the important inducements which led the owners of the Glen Cove factory to dispose of their plant was the hope of retiring from active business. Hiram Duryea accepted the Presidency at first because of the large interest of the Duryea family in the success of the combination. At the earliest opportunity he

[1] As an illustration of the value of trade-marks in the starch industry one may note that even at the present time (1913) the wholesale price of the best-known box starch for eatable purposes, " Duryea's Glen Cove Corn Starch " is nearly twice that of a similar starch sold under a less well-known trade-mark. This extra price, over and above the competitive price of the starch alone, is of the nature of an economic rent on the trade-mark. As " rent " it can be capitalized. So that the capitalization of trade-mark earning power is not to be considered over-capitalization any more than the capitalization of business sites. The difficulty comes in determining a constant earning capacity, a standard " rent," which can be legitimately used as the basis for capitalization.

withdrew and subsequently sold his securities in the National Starch Manufacturing Company. William F. Piel, Jr. was advanced to the Presidency. Instead of following the policy of maintaining prices at a remunerative level the new management attempted to drive competitors out of the business by cutting prices. The panic of 1893 and the succeeding years of depression made conditions in the bulk starch business particularly hard. Competition from the western manufacturers of glucose increased in severity and the National Starch Manufacturing Company found itself in a secure position only in regard to its widely advertised trade-mark brands. As a result the earnings of the Company fell off rapidly. On July 1, 1893 the regular dividend on the second preferred stock was passed "on account of excessive competition during the last winter and spring, and the present dulness of the trade."[1] Soon afterward the dividend on the first preferred stock was passed and in the following year no dividends were paid.

It was stipulated in the original contract under which the Company purchased the factories that no manufacturer should "engage in the starch business" during a period of five years.[2] This was adhered to, but after the expiration of the five years several manufacturers began again to operate competitive plants. In the autumn of 1895, in order to create a business for his sons and for certain old employees of the Glen Cove factory toward whom the new management had been inconsiderate, Hiram Duryea assumed the financial responsibility of a wholesale jobbing business in New York City. The partnership, known as Duryea & Company, became agent for a starch factory in Sioux City. The product of this factory was marketed under the partnership name. It proved of inferior quality, and to maintain the good reputation of his name in the starch business, Mr. Duryea and his sons bought the plant.[3] The factory was remodelled and

[1] 56 *Chron.* 1015, June 17, 1893.

[2] Agreement between Cumberland Investment and Security Company and eighteen vendors, dated January 31, 1890.

[3] The Sioux City plant was in very bad shape and was purchased by the Duryeas at about 60% of its capitalized value. A considerable sum was spent in remodelling it.

the product very much improved.[1] As a result severe competition followed between Duryea & Company and the National Starch Manufacturing Company.

These highly competitive conditions continued for several years. In 1899 a promoter [2] in New York conceived a plan of uniting into a new Company the four most important box starch competitors outside of the National Company and eventually harmonizing all the interests. Allen, the promoter, brought the plan to the attention of Charles R. Flint of New York who had attained a considerable reputation for launching industrial combinations. The latter agreed to take hold of the promotion and secure, through a trust company loan, the money necessary to make the payments required by the vendors. A meeting was held June 30, 1899, at Mr. Flint's office where the financial details of the new Company were arranged.[3] The outcome of

[1] In fact Mr. C. B. Duryea developed an improved "thin boiling starch" at the Sioux City plant, which was superior to any then produced. The invention of thin boiling starch has been attributed to Dr. Behr. (Wagner, in 1909 *J. Soc. Chem. Ind.* 346.) The matter is a subject of controversy.

[2] George M. Allen.

[3] To illustrate the tentative manner in which such combinations were frequently consummated, a copy of the original memorandum is given here.

MEMORANDUM OF MEETING held at the office of Charles R. Flint, June 30th at 10 A.M.

Present, Messrs. Flint, Auerbach, T. P. Kingsford, Higgins, Duryea, Morton, and Allen.

It is agreed to organize the United Starch Company with a capital of $2,500,000 preferred, six per cent cumulative stock, and $3,500,000 common stock. And that the former shall be held in trust by the U. S. Mortgage & Trust Co. and issued later through bankers to be provided by Mr. Flint. The common stock shall also be held in trust for the owners for such a time as they may elect.

It is agreed and understood that the vendors shall receive $950,000, in cash, $1,550,000 preferred stock and $3,000,000 in common stock, for their plants and inventories, to be provided for as follows:

First, a loan shall be made by the U. S. Mortgage & Trust Co. for $950,000 for nine months, same to be paid from the proceeds of the sale of an equal amount of preferred stock to be issued at such time as in the judgment of the Directors may be proper. The proceeds of this loan to be used as follows:

To pay Kingsford	$400,000
Morton	175,000
Graves	350,000
Duryea	25,000
Total	$950,000

Second, in addition to the cash paid as above, preferred stock shall be assigned to the vendors as follows:

this was that the United Starch Company was formed September 1, 1899. It acquired the business of the Duryea & Company and the Sioux City Starch factory, the Argo Starch factory of Nebraska City, controlled by Joy Morton, and the entire capital stock of Kingsford's Oswego Starch factory. In addition the Company purchased outright the business and factory of Gilbert S. Graves of Buffalo, N.Y. To obtain the money necessary to purchase the various plants and supply the Company with working capital the promoters [1] gave a mortgage of $1,250,000 on the entire assets to secure a short time bank loan amounting to $950,000. The United Starch Company was capitalized for $5,026,300 of which $1,526,300 consisted of 6% preferred, and the balance, $3,500,000, of common stock. Altogether the issued capitalization of the consolidation amounted to approximately $6,000,000.[2] At the time of its formation the

Kingsford	$1,100,000 — on plant and inventory
Morton	125,000 — on plant
"	100,000 — on inventory
Duryea	75,000 — on plant
"	100,000 — on inventory
Graves	50,000 — on plant
Total	$1,550,000

which shall be held in trust by the U. S. Mortgage & Trust Co. for account of the owners until the time of issue.

$3,000,000 of common stock is to be issued to the vendors in part payment of real and personal property turned over to the new company, as follows:

Kingsford	$2,422,500
Morton	255,000
Duryea	322,500
Total	$3,000,000

Included in the property turned over by the vendors it is estimated that there will be about $750,000 of quick assets, consisting of grain, package materials and starch, manufactured and in process.

$500,000 in common stock shall be paid to cover the entire costs of promoting the company, including the charter, the organization, the commission paid in stock for securing the loan, the fee of the bankers who issue the preferred.

Common stock to vendors	$3,000,000
Common stock to promoters	500,000
Total common stock	$3,500,000

[1] This method of financing was arranged by Chas. R. Flint.

[2] Distribution of the capitalization of the United Starch Company at time of issue.

	Cash	Preferred Stock	Common Stock
For real estate:			
Kingsford	$400,000	$1,100,000	$2,422,500
Morton	175,000	125,000	255,000
Duryea	.. .	100,000	322,500
Graves	250,000	100,000	

combination was producing an amount of starch practically equal to that of the National Starch Manufacturing Company, the output of which, actually, and relatively to its competitors, had steadily decreased since 1892.

The financial condition of the National Starch Manufacturing Company was kept secret. The only information vouchsafed the public was that contained in the balance sheet of December 31, 1898. It was meagre and served to confirm, rather than allay, any suspicions of financial unsoundness.[1] By July, 1899, the amount of unpaid dividend had accumulated to $38 a share on the first preferred stock and $82 a share on the second preferred

	Cash	Preferred Stock	Common Stock
For inventories:			
Kingsford (included in previous)	....	..	
Morton	$18 47	$31,600	
Duryea	25,064.36	69,700	
Graves	39,704.85	....	
For promoters: *			
Allen and Flint	....	....	$500,000
Working capital:			
Cash	60,212.32	. .	
Totals	$950,000	$1,526,300	$3,500,000
(Treasury of Company		$23,700)	

1 BALANCE SHEET, DECEMBER 31, 1898

Assets

Permanent Investment	$11,392,572
Redemption of Bond Account	571,935
Bonds for Sinking Fund	1,166,000
Sundries	266,992
Receivables	1,211
Products and Supplies	553,036
Unexpired Insurance	17,206
Cash	148,227
	$14,117,179

Liabilities

Capital Stock:	
First Preferred	$ 2,219,400
Second Preferred	1,846,800
Common	4,450,700
Bonds (May 1, 1920, interest semi-annually)	4,287,000
Sinking Fund Reserve	1,215,510
Sundries	123,117
Discount on Bonds Purchased	9,820
	$14,117,179

This report was exceedingly interesting, from the standpoint of the accountant. An item of " Bills Receivable " occurs among the assets, but no bills or accounts payable, or similar items among the liabilities. The interest on the bonds was payable semi-annually, March and November, and yet there was no liability, apparently, on December 31st, for accrued interest. Assets were swelled by unexpired insurance, with no corresponding account for accrued or contingent liabilities. As a whole, the report shows a " permanent investment " of over $11,000,000 (68 *Chron.* 328). It later developed that the Company had a large volume of outstanding notes upon which it was contingently liable.

* The promoters' share went very largely to Flint.

stock, and the market value of the Company's securities had fallen to speculative levels.[1]

About the time of the formation of the United Starch Company rumors were circulated that an entirely new combination was to be formed which should harmonize the conflicting interests. Meanwhile a syndicate agreement was prepared under date of October 5, 1899, which looked to the acquisition of the stocks of the National Starch Manufacturing Company with a view to reorganizing the Company. By this agreement, the managers of the syndicate[2] offered to buy the securities of the old Starch Manufacturing Company on the basis of $75 a share for the first preferred stock, $30 a share for the second preferred stock, and $10 a share for the common stock.[3] These figures were slightly above the market quotations. Those holders who deposited their stocks had the option of becoming members of the purchasing syndicate, and participating in the reorganization of the Company. The terms of this reorganization were not divulged until later. By January 10, 1900, holders of 75,149 shares out of the total of 85,169 shares had signed the syndicate agreement and it was therefore declared operative.[4] At about the same time, a Committee of three of the larger stockholders of the United Starch Company was arranged to coöperate with

MARKET PRICES AND DIVIDENDS

NATIONAL STARCH MANUFACTURING COMPANY'S SECURITIES

		Bonds 6%	First Preferred 8%	Second Preferred 12%	Common
1891	Average Price	98	110	115	54
	Dividend Payment	6	8	12	1
1892	Average Price	102	101	103	33
	Dividend Payment	6	8	12	0
1893	Average Price	98	103	103	32
	Dividend Payment	6	4	6	0
1894	Average Price	92	50	37	9
	Dividend Payment	6	0	0	0
1895	Average Price	95	53	31	8
	Dividend Payment	6	0	0	0
1896	Average Price	95	57	21	7
	Dividend Payment	6	4	0	0
1897	Average Price	100	65	21	5
	Dividend Payment	6	4	0	0
1898	Average Price	103	81	27	8
	Dividend Payment	6	2	0	0
1899	Average Price	103	68	27	7

[2] Joy Morton, Chas. R. Flint, Alexander H. Stevens, W. E. Roosevelt, George W. Young. It will be seen that two of these men were concerned with the promotion of the United Starch Company, whereas none were prominent in the National Starch Manufacturing Company.

[3] Reorganization Agreement, October 5, 1899.

[4] Circular of January 10, 1900.

the Reorganization Committee of the Starch Manufacturing Company.[1] As a result of these negotiations, a plan of reorganization and consolidation was arranged, and submitted to the stockholders of the National and of the United Companies under date of April 9, 1900.

The Reorganization Committee proposed to acquire, in the interests of a new corporation, to be called the National Starch Company, at least a majority of the stocks of the National Starch Manufacturing Company of the United Starch Company, and of the United States Glucose Company. This latter concern held control of the United States Sugar Refining Company which owned a glucose and starch factory at Waukegan, Ill.[2] The securities of all three Companies were exchanged for those of the National Starch Company. A large part of the stocks of the old Starch Manufacturing Company had been acquired by the managers of the reorganization syndicate on a money basis, as outlined in a previous paragraph. The members of this syndicate who had contributed either money or National Starch Manufacturing Company's stocks were given, for each $100 subscribed, $37.53 [3] in new National Starch Company's debenture

[1] As a matter of fact the plan of union had been worked out by Chas. R. Flint and Joy Morton long before the details were presented to the public. The reorganization was actually in the hands of promoters of the United Starch Company.

[2] The United States Sugar Refining Company, the operating corporation, was organized September 3, 1893. It manufactured a low-grade bulk starch for manufacturing purposes. The Company converted a large part of its product into commercial glucose so that it was, perhaps, a more considerable factor in the commercial glucose business than in the starch business. The holding corporation, the United States Glucose Company, was organized May 27, 1899. The underlying Sugar Refining Company had outstanding $1,000,000 first mortgage 6 % bonds. Its stock consisted of $2,000,000, all of one class. The United States Glucose Company, the holding Company, had, in 1899, acquired $1,811,600 of the Refining Company's single class stock by issuing its own stocks in the proportion of 25 % in 6 % cumulative preferred stock and 75 % in common stock. In this way $452,900 of the preferred and $1,358,700 common stock had been issued to acquire the $1,811,600 of stock held in the treasury of the holding company. In addition $47,100 of the preferred and $141,300 of the common stock were reserved to acquire the $188,400, the outstanding minority interest in the Refining Company. (Data partly from Reorganization plan of April 9, 1900, partly from New York Stock Exchange Listing Application A-2465 and partially from indirect sources.

[3] $37.5282 Reorganization Agreement, April 9, 1900.

bonds and $92.71 in new preferred stock.[1] In accordance with this plan a subscriber to the National Starch Manufacturing Company Reorganization Syndicate received $130.24 in bonds and preferred stock of the new Company. The stockholders of the United Starch Company received debenture bonds of the new Company in exchange for their preferred stock taken at par; and new preferred stock for their old common stock on the basis of 45% of its par value. Enough bonds were reserved to discharge fully the bank loan of $950,000 when it should mature. In the case of the United States Glucose Company, the Committee held $257,000 of preferred stock in the interest of the new Company, out of a total of $500,000 [2] issued and reserved; also $771,000 of common stock out of a total of $1,500,000.[3] The Reorganization Committee exchanged this majority holding in the Glucose Company for $2,225,000 of the new common stock of the National Starch Company. The Committee met its expenses by the issue of $140,000 in bonds, and was compensated for its labor by the issue of $125,000 in preferred stock. A table showing the capitalization of the constituent companies and that of the new National Starch Company is inserted on the following page.

The figures expressing the reorganization bore little relation to actual conditions. Although the total outstanding capitalization was somewhat decreased, the securities bearing fixed charges were actually increased. The old bonds were allowed to remain undisturbed and new bonds to the amount of over $3,000,000 were created where there were none before. Interest charges were actually increased from $297,000 (the charges for all the companies prior to the consolidation) to $422,000. Considering the embarrassed condition of the National Starch

[1] $92.7144. Should the subscriber prefer, he might take $61.81 in both preferred and common stocks of the National Starch Company instead of $92.71 in the preferred stock alone. Few subscribers availed themselves of the option, which indicated a general skepticism regarding the new Company.

[2] $452,900 issued, and $47,100 reserved to take up a like amount of underlying United States Sugar Refining Company stock.

[3] $1,359,700 outstanding, and $141,300 reserved to take up the underlying United States Sugar Refining Company stock according to plan outlined in note, page 64.

REORGANIZATION OF NATIONAL STARCH MANUFACTURING COMPANY

	Securities of Old Companies given in Exchange					National Starch Company's Securities					
	Bonds	Fixed Charges	Preferred Stock	Contingent Charges	Common Stock	Underlying Bonds	Debentures	Fixed Charges	Preferred Stock	Contingent Charges	Common Stock
									6%		
National Starch Manufacturing Company:											
Bonds 6%	$3,000,000	$180,000	....	....	....	$3,000,000	....	$180,000			
First Preferred Stock 8%	...	...	$2,219,400	$177,552	....	....					
Second Preferred Stock 12%	....	....	1,846,800	221,616	...	....	$1,000,000	50,000	$2,470,524	$148,231	
Common Stock	....	....	....	....	$4,450,700	...					
United Starch Company:											
Bonds 6%	950,000	57,000	....	...	....	...	950,000	47,500			
Preferred Stock 6%	....	....	1,550,000	93,000	....	...	1,550,000	77,500			
Common Stock	....	....	...	..	3,500,000	....	..	....	1,575,000	94,500	
United States Glucose Company:											
Bonds (Underlying) 6%	1,000,000	60,000	..	...	.	1,000,000	....	60,000			
Preferred Stock 6%	....	..	500,000	30,000	...	....	...	.	....	..	$2,250,000[1]
Common Stock	....	....	....	..	1,500,000	...	...	...	...	...	
Expenses and Compensation of Committee	....	...	....	...	..	....	140,000	7,000	125,000	7,500	
Totals	$4,950,000	$297,000	$6,116,200	$522,168	$9,450,700	$4,000,000	$3,640,000	$422,000	$4,170,524	$250,231	$2,250,000[2]

SUMMARY	Old	New	Change: Amount	Change: Percentage New to Old
Securities bearing Interest	$4,950,000	$7,640,000	+$2,690,000	154%
Securities bearing Fixed and Contingent Charges ..	11,066,200	11,810,524	+ 744,324	107%
Total Securities	20,516,900	14,060,524	− 5,456,376	69%
Fixed Charges	297,000	422,000	+ 125,000	142%
Fixed and Contingent Charges	819,168	672,231	− 146,937	71%

[1] To syndicate for majority of the U.S. Glucose Co.'s stock.

[2] This was increased to $2,594,325 because some of the syndicate subscribers took *two* shares of Common instead of *one* of Preferred Stock in accordance with the reorganization plan. The proportion was, however, so small that it seemed clearer to base the comparison on the assumption that the members of the National Starch Manufacturing Company Syndicate took all Preferred and no Common Stock.

Manufacturing Company, which must have been known to the promoters, a further addition to the fixed charges was not in accord with wise business policy.

Other considerations than conservatism lay in the background of the minds of the promoters of the National Starch Company. They believed there was a possibility of creating a monopoly in the starch trade. In spite of the severe competition the National Starch Manufacturing Company had been paying the interest on its bonds. The other two constituents were, apparently, in a prosperous condition financially. The reorganization was consummated for the sole purpose of allaying the serious consequences of drastic competition in an industry where there was over-production in all lines of manufacture and where one manufacturer had an advantage over another only in skill of factory management, or in the special trade-mark under which he sold his starch. It was hoped that through the union of all the prominent starch manufacturers and through the acquisition of practically all of the familiar trade-marks the reorganized Company would be in a position to dominate the industry. Profits must needs increase under these conditions. Here, therefore, when the reorganization turned more on the creation of a monopolistic position than on the financial rehabilitation of the constituent corporations, one would not expect a conspicuous reduction in either total capitalization or fixed charges. The fact that there was any reduction in total capital can be ascribed to the low market prices for the old Starch Manufacturing Company's stocks and the general feeling that the old Company had been over-capitalized.[1] The fact that the fixed and contingent charges were not reduced can be attributed to the general optimism of the promoters and the feeling that, once competition between the principal starch makers had ceased, the new Company would experience marked prosperity.

It is difficult to form an accurate estimate of the value of the new National Starch Company's properties from internal evi-

[1] For example William F. Piel, Jr., in his affidavit to the Industrial Commission June 5, 1901, directly after the organization of the National Starch Company, states "In the National Starch Manufacturing Company there was beyond question an over-capitalization." XIII *R. I. C.* 672.

dence alone. On the one hand, two men, closely connected with the organization, asserted under oath,[1] that the tangible assets of the National Starch Company were equivalent to the bonds and preferred stock. These together amounted to $11,810,524. On the other hand, these gentlemen stipulated in their plan of reorganization that the new stock should be deposited in a voting trust, and that the Committee could dispose of the preferred stock for $90 a share. Furthermore, it will be remembered that the same Committee proposed to issue to the syndicate subscribers, for each $100 in money, $130 in bonds and preferred stock. It might seem, therefore, that these gentlemen either forced a particularly bad bargain on the subscribers to their syndicate, or else were ignorant of the true value of their property. Looked at in terms of the cost of reproduction, it is difficult to see how plants as old as those of the National Starch Company, with a merchantable capacity of not more than 40,000 bushels of corn a day at the very most, could be estimated as worth more than $4,000,000. The working capital would demand approximately $1,000,000 more, so that the total value of the National Starch Company could not have exceeded $5,000,000 [2] by the most liberal estimate within reason.

At the time of the promotion of the National Starch Company, Menzies, Robertson & Co., chartered accountants, reported average earnings of $737,578.50 for the constituent companies during a period of five years, and earnings of over $1,000,000 during the year 1900.[3] When the new Company was on its feet the accountants reported for January 1, 1901, a book surplus of the National Starch Company of $1,046,049.85.[4] This first general balance sheet of the New Company was embodied in the listing application to the New York Stock Exchange. A little over a year later the management wished to have more deben-

[1] C. R. Flint, testimony before Industrial Commission. XIII *R. I. C.* 67; Affidavit of W. F. Piel, Jr., XIII *R. I. C.* 673.

[2] It was actually less as the National Starch Company became immediately a heavy borrower at the banks in order to obtain working capital.

[3] Kean, Van Cortlandt and Co., Circular. Also N. Y. Stock Exchange Listing Application A–2465.

[4] N. Y. Stock Exchange Listing Application A–2465.

ture bonds admitted to the list of the Exchange and filed a second statement, as of February 28, 1902. It is interesting to compare these two balance sheets. Allowing for a different method in stating bonded liabilities, it appears that "Permanent Investment" changed from $13,000,000 to over $15,000,000.[1] The "plant" of the United States Sugar Refinery at Waukegan was put among the assets, and certain bonds of this Company, held as "investments," also among the assets. By the Company's methods of accounting the surplus increased from $1,046,050 to $2,132,947. In other words the Company, according to its methods of accounting, not only earned and paid the entire fixed charges and the preferred stock dividend, but also added to its surplus over $1,000,000. Its earnings, therefore, between January 1, 1901 and February 28, 1902, must have amounted to no less than $1,750,000, if the two balance sheets present correct pictures of the business. On the strength of this showing, interest was paid on the bonds, and quarterly dividends on the preferred stock, for a period of two years. At the same time Kean, Van Cortland & Co. were offering to the public [2] a considerable block of the new Starch Company's bonds, practically the entire issue having been admitted to the list of the New York Stock Exchange.[3] From the conditions of the reorganization, it is evident that a small coterie in the direct management had received a large part of these bonds.

The National Starch Company proved no greater success than its predecessor. Although the new combination manufactured approximately 90% [4] of the box starch manufactured in this

[1] $13,058,440.52 to $15,359,024.44.

[2] Circular offering bonds at 92½%. With an almost humorous naïveté they state, "The tangible assets of the Company . . . are largely in excess of the entire bonded debt. We recommend these bonds as security of undoubted value."

[3] April 13, 1901. Application A–2465.

[4] April 13, 1901. N. Y. Stock Exchange Listing Application A–2465. This seems not to have been an exaggeration. The percentage of bulk starch was not as high, as many of the manufacturers of commercial glucose were placing a low-grade starch on the market. The total percentage of the whole starch industry controlled by the National Starch Company was probably between 70% and 80%. It would vary somewhat owing to fluctuations in the market price of commercial glucose, which would influence the relative amounts of low-grade starch converted into glucose or sold as starch.

country, controlled absolutely the domestic market, and exported large quantities to all parts of the world, the profits were much less than had been expected. The cost of marketing box starch continued high. A rise in the price of corn reduced, to a considerable degree, the consumption of starch for the sizing of cloth as cotton mills usually prefer a potato starch unless the price of corn starch is particularly low. There are no important basic patents in either the starch or glucose business, so that independent mills readily sprang up. These newer independent mills introduced an hydraulic process for the making of bulk laundry and mill starch which shortened the process of manufacture and reduced its cost. In the presence of these unfavorable conditions the profit on the manufacture and sale of starch grew steadily less.[1] The Company used every means to maintain its position and became a heavy borrower at the banks, till no less than $1,200,000 of its commercial paper was outstanding toward the end of its separate existence. The same management directed the trade policy of the National Starch Company that controlled the National Starch Manufacturing Company, and the same blunders and mismanagement continued. The financial administration was largely in the hands of Joy Morton of the United Starch Company and proved not wise, conservative, or successful.

As a last effort to regain a position in the trade, and in part to retaliate against the glucose manufacturers who had entered

[1] The following table giving the average price of starch for the period of years covered by the National Starch Manufacturing Company and its successor was inserted at the end of the Piel affidavit in the report of the Industrial Commission. The present writer does not think the figures very important or instructive as the starch industry is divided into two parts, — box starch and bulk starch. The wholesale prices of the two are based on entirely different considerations, so that an average price of " starch " gives very little indication of competitive conditions in either field. He has not attempted to check or verify the figures by collateral evidence.

AVERAGE PRICES OF CORN AND STARCH FROM 1890 TO 1900 INCLUSIVE

Year	Corn per Bushel Cents	Starch per Pound Cents	Year	Corn per Bushel Cents	Starch per Pound Cents
1890	48.1	4.1	1896	34.	2.7
1891	70.4	3.7	1897	31.9	2.1
1892	54.	3.1	1898	37.6	1.9
1893	49.9	3.2	1899	41.3	2.
1804	50.9	3.2	1900	45.3	2.1
1895	47.7	3.2			

the bulk starch market, the National Starch Company increased its production of commercial glucose. Here it met the competition of a large glucose consolidation organized in 1897. Subsequently, the two were reorganized into the Corn Products Company; but before discussing this later development, it is important for the understanding of our narrative to outline the previous history of the glucose consolidation.

CHAPTER IV

The Reorganizations of the Glucose Combination

The manufacture of glucose, 72; early history of the industry, 73; the glucose "pool," 75; the promotion of the Glucose Sugar Refining Company, 76; value of the property of the Glucose Sugar Refining Company, 78; the early history of the Company, 82; early difficulties, competition, and mismanagement, 83; the steps taken toward the promotion of a new consolidation, 87; organization of the Corn Products Company, 89; the distribution of securities, 90; estimates of its value, 93; Company confronted by new competition, 95; earnings during the first two years, 96; the bad management, 97; formation of the Corn Products Refining Company, 103; the value of the property of the Company, 106; later history and a summary of the whole, 108.

Chronological Summary

1811. Discovery of method of manufacturing glucose.
1860. Introduction of glucose into the United States.
1873. First important factory for the preparation of glucose.
1881. Establishment of the Chicago Sugar Refining Company.
1885. Formation of first glucose "pool."
1890. Abandonment of the "pool."
1897. Formation of the Glucose Sugar Refining Company.
1902. Formation of the Corn Products Company.
1906. Formation of the Corn Products Refining Company.

In 1811 the chemist Kirchhoff, while trying to discover an artificial method for the manufacture of cane sugar, noticed that dilute acids changed starch into a mixture of various kinds of sugars. This discovery lies at the basis of the present method of the manufacture of commercial glucose. As now prepared corn starch is brought in contact, under pressure, with a dilute solution of hydrochloric acid.[1] The starch is converted into a mixture of glucose sugars and the chlorine of the acid is removed by neutralizing it with sodium carbonate, so only common salt remains.[2] The commercial glucose resulting is a water solution

[1] Concentration about .08 %.

[2] This process of conversion is not allowed to run to completion. Such a reaction would result in true glucose or dextrose.

of various glucose sugars,[1] neutral, and non-crystallizable at all degrees of concentration. Latterly, there has been a tendency to confuse true glucose or dextrose with the mixture of sugars sold as commercial glucose.[2] Commercial glucose contains less than 25 % of true glucose.

Commercial glucose or the glucose of common speech is a wholesome almost chemically pure sugar. It forms the basis of candy manufacture owing to the property of dissolving nearly its own weight of cane sugar, forming an uncrystallizable mixture. It is very cheap, enabling the candy manufacturers to realize a very liberal rate of profit on all grades of candy. It is the basis of all manufactured jellies, preserves, "fillings" and similar products, and of imitation maple syrup and honey. When rightly used, and not misbranded, it is a valuable food, a wholesome sugar of great purity and cheapness.[3]

The manufacture of glucose was introduced into the United States about 1860, but was at first of inconsiderable importance. The earliest extensive and permanent factory was established

[1] The composition of commercial glucose varies slightly according to the methods of preparation. "As now prepared by the Corn Products Refining Company it is, in round numbers, a water solution containing from 80–84 % carbohydrates, 0.5 % ash and other organic matter, corresponding to .08 % nitrogen in combination. The carbohydrates consist of malt sugar (maltose) 45 %, grape sugar (dextrose, properly designated, glucose) 20 %, dextrine 35 %." Authority of Professor George W. Rolfe, Massachusetts Institute of Technology.

[2] In the remainder of this narrative, for the sake of simplicity, the term glucose is used rather than "commercial glucose," which more properly refers to the mixture of sugars manufactured through the partial hydrolysis of starch.

[3] Efforts have been made to exclude the use of commercial glucose from manufactured articles of diet on the strength of pure food legislation. Such efforts spring largely from prejudice. All the reliable evidence points to a belief in the thorough wholesomeness of commercial glucose as a food. In fact the cane sugars have to be converted by the digestive enzymes before they can become a true food. Ordinary molasses is an impure form of glucose sugars, "never exceeding 75 % carbohydrates purity" (Professor Rolfe); whereas the commercial glucose is upwards of 99 %. Furthermore, commercial glucose contains a larger percentage of maltose than molasses. Maltose, being less easily fermented in the stomach than the most of the molasses sugars, serves as a better food. All things considered, the unprejudiced observer cannot but regret the popular feeling against the use of glucose. This is especially regrettable considering its cheapness, — less than two cents a pound.

in Buffalo, New York, about 1873 by Cicero J. Hamlin.[1] For a number of years the American Glucose Company, as the Hamlin plant was called, was the only important producer of glucose in the country and the profits in the business were very large. In 1874, the Glen Cove starch factory began to convert a part of its product into glucose and other competitors arose in the vicinity of Buffalo[2] and in the West. The most important competitor of the American Glucose Company was a Chicago concern called the Chicago Sugar Refining Company. This Company had built a large plant in 1881 for the purpose of manufacturing, on a commercial scale, a crystalline form of glucose sugar known as "anhydrous sugar."[3] The promoters of the undertaking were F. O. Matthiessen, and W. A. Wiechers,[4] two cane sugar refiners who hoped to be able to use this anhydrous sugar as an adulterant for cane sugar. They had interested several Chicago capitalists in the undertaking[5] and altogether $1,250,000 was invested. It was discovered too late that the anhydrous sugar absorbed water from the atmosphere and caked into solid lumps. It was, therefore, valueless except for use in the brewery business. Finding the sale of anhydrous sugar restricted to small compass, and having already suffered

[1] Hamlin was a dry-goods merchant who had endorsed the paper of Fox and Williams vinegar manufacturers. The latter failed and Hamlin began the manufacture of glucose. For some years he was the largest manufacturer, but glucose was little used and most people were suspicious of its use in foods.

[2] For example, a glucose plant built by one Firmenich, in Buffalo, to compete with the American Glucose Company was bought out by the latter at a fictitious price. Firmenich then bought an old malt-house at Marshalltown, Iowa, and commenced to manufacture glucose in 1887. (See page 79.) He acquired wealth by equipping old factories for the purpose of selling them to the Whiskey Consolidation.

[3] Developed by Dr. Arno Behr, a chemist who has had much to do with the technical progress of starch and glucose chemistry in this country.

[4] F. O. Matthiessen and Wiechers Sugar Refinery. Absorbed by the American Sugar Refining Company.

[5] Martin Ryerson, Cyrus McCormick, Leiter and Marshall Field. F. O. Matthiessen induced his brother E. A. Matthiessen, who had then retired from business and was living in Europe, to return to this country and assume the Presidency of the new Company. Thereafter, E. A. Matthiessen and his son, C. H. Matthiessen dominated the business policy of the Company.

a considerable loss,[1] the Company turned toward the manufacture of glucose, where it could operate in an established industry where profits were reasonably assured. The plant of the Chicago Sugar Refining Company subsequently, in 1897, formed the nucleus of the first consolidation of glucose manufacturers.

In 1884, an investigating committee, appointed by the Government, published a report that glucose was wholesome. Before this time there had been an almost universal prejudice against its use, which very materially restricted its sale. But after the wide publication of the Government report, the demand so increased that a large number of small glucose factories started up in the middle west. As a result a glucose "pool" was formed for the first time in the summer of 1885, and the same "pool," with various intermissions of several months and changes in proportional allotments, existed until 1890.[2] The parties to the pool included the most important manufacturers. In conference the members determined upon the amount of glucose that could be profitably sold, and each manufacturer marked upon a piece of paper the maximum capacity of his plant. His proportional allotment was determined by the ratio of his maximum capacity to the sum of capacities. At first the American Glucose Company had 65% of the entire market and the remaining 35% was distributed among all the other manufacturers. Gradually, as the newer producers increased their production, the allotments were changed until, toward the end of the pool, the American Company had 45% of the market and the other manufacturers 55%. A special examiner[3] audited the books of each member of the pool and reported to a central organization. Every manufacturer who had sold in excess of his allotment paid into the pool ½ cent for every pound of the difference. Every

[1] Estimated for the present writer by two separate and distinct manufacturers as $800,000.

[2] It has been very difficult to ascertain the exact facts concerning this pool. There were no written agreements. The facts stated in this paragraph have been gleaned from four different and widely separate sources. They are believed to be thoroughly reliable.

[3] W. C. Harmon.

manufacturer who had not sold his allotment drew out from the pool ½ cent for every pound of the difference. During the period the American Glucose Company nearly always "drew out" while some of the newer and more active competitors, particularly the Charles Pope Glucose Company, "paid in" to the pool's treasury.[1] The administration of the pool was somewhat difficult owing to suspicions held by some members toward others and to instances of underselling and false reporting.[2] The pool was finally broken up in 1890, by the refusal of the Chicago Sugar Refining Company to become longer a party to its agreements.

In the years following the dissolution of the pool severe competition existed among the various manufacturers of glucose. The Chicago Sugar Refining Company increased its output until it became the largest producer in the country. At the same time the depression of the middle nineties and the competition of the smaller plants reduced the margin of profit to such a low point that numerous factories were closed and others were

[1] Pope had been a maltster who entered the glucose business with one Turner at Geneva, Illinois, forming, June 23, 1880, the Geneva Grape Sugar Company. The factory of the Company had been used as a flour mill. Pope gradually eliminated his partners at Geneva, and by an aggressive business policy became, by 1887, one of the foremost manufacturers. The name of his Company was changed January 30, 1888, to the Charles Pope Glucose Company. During the life of the pool this Company was very successful, in spite of the fact that it usually "paid in" to the pool's treasury. In 1888, at the time of the change of name, the Company built a glucose refinery at Venice, Ill., opposite St. Louis. This factory did not prove a success owing to trouble with cheap fuel, poor labor and river floods. Although Pope's importance in the industry declined after 1890, he was "approached" to enter the first glucose consolidation formed in 1897. His business was finally absorbed at the time of the formation of the Corn Products Company in 1902.

Pope was one of the most remarkable men in the industry, according to reports, and the importance of the man far exceeded the importance of his refineries. The son of an English emigrant he achieved success first as a building contractor and later as a maltster. He possessed extraordinary skill as a factory superintendent and as a judge of corn. He customarily bought odd lots of "ungraded" corn for his refineries on the basis of his own judgment and was able thereby to cut the cost of his raw material, below that of his competitors.

[2] For example, it was reported on excellent authority that the Firmenich Co. kept two sets of books, one for the pool's examiner and one for the shipments.

operated at a loss.[1] These were the conditions in the glucose industry, when, in the winter of 1896–97, with the first signs of returning business prosperity, a promoter [2] of Peoria, Ill., conceived the idea of a glucose consolidation which should include all the important manufacturers. The production of glucose had, by this time, been concentrated in Chicago and the middle west [3] and local combination had progressed so far that the industry was entirely in the hands of less than a dozen separate producers. The promoter of the combination had the coöperation of C. H. Matthiessen whose family controlled the Chicago Sugar Refining Company,[4] and N. B. Ream, an influential, but not the largest, stockholder of the Rockford Sugar Refining Company. This group of men easily secured options on the plants of the American Glucose Company and the Peoria Grape Sugar Company, both located in Peoria. In addition they obtained options on three smaller refineries at Rockford, Illinois, and Davenport, and Marshalltown, Iowa. Altogether the six plants had a rated capacity of 100,000 bushels of corn a day, and were able to grind about 74,000 bushels. They controlled, in 1897, approximately 85% of the American production of glucose.[5] The Charles Pope Glucose Company was not included because it had, during the preceding years of depression, turned to the manufacture of starch and had even mortgaged its plant. Apparently of inconsiderable importance, the promoters of the

[1] This was due largely to the aggressive price cutting of J. W. Doane, who owned upward of 75 % of the stock of the Rockford Sugar Refining Company, and controlled its policy. Although the Company was not a large producer of glucose, the prices it established were followed by the larger manufacturers.

[2] Joseph B. Greenhut.

[3] The American Glucose Company had built a refinery at Peoria, Ill.

[4] At the time of the promotion, 1897, there were only 60 stockholders in the Chicago Sugar Refining Company. Of the 12,500 shares, 1,770 were held by F. O. Matthiessen, the largest stockholder, 1,750 by C. H. Matthiessen, and 1,494 by E. A. Matthiessen. Altogether the Matthiessen family held over half the shares.

[5] This estimate is based upon the assumption that Charles Pope was, at the time, producing only a small amount of glucose and that the National Starch Manufacturing Company had not materially increased its output. Almost as soon as the combination was organized, conditions changed, but the above estimate of 85 % of the country's production was probably about correct for the spring and summer of 1897.

glucose combination did not see fit to pay any considerable price for it.[1] This was a mistake, for the subsequent competition of Pope in the New England candy market proved a serious obstacle to the combination.[2]

With the options on the six glucose renneries in hand, the promoters caused to be formed, August 3, 1897, the Glucose Sugar Refining Company. It was a New Jersey corporation with $40,000,000 of authorized capital stock, — $14,000,000 of 7% preferred stock and $26,000,000 of common stock. The acquisition of the six plants involved the payment of $3,000,000 in money, approximately $9,000,000 in preferred stock, and $14,000,000 in common stock. In addition $1,550,000 was raised for working capital, the greater part of which was immediately expended in the purchase of the inventories of the subsidiary plants.[3] The most valuable property was that of the Chicago Sugar Refining Company. The plant was in fairly good condition and the Company, through the technical achievements of Dr. Behr, had been able to introduce improved methods of manufacturing glucose and recovering the by-products; and the land upon which it was situated was of very considerable value. Its real worth was probably about $3,000,000.[4] The Peoria plant of the American Glucose Company was in very poor condition.[5] Although $2,250,000 in money was paid for it, the

[1] At the time of the preliminary plan of the organization $700,000 preferred stock and $1,000,000 common stock was set aside to use in acquiring the Pope property. But there was doubt on the part of the promoters and in the agreement of June, 1897, a provision was inserted to the effect that if the Charles Pope Company were not acquired, the above stock would remain in the treasury of the Glucose Sugar Refining Company.

[2] *Supra*, p. 76, note.

[3] "Every company showed a disposition to make its inventory as high as possible." Statement of a man familiar with the adjustments.

[4] Two authorities have expressed opinions of the value of this plant, giving $2,000,000 and $4,000,000 respectively. The earning capacity of the Company was, however, great. It had earned and paid 40% in dividends on $1,250,000 capital during the preceding years when other glucose companies were on the verge of failure.

[5] The facts and opinions expressed in this paragraph are based on many expressions of opinion given the writer by men intimately familiar with the individual plants absorbed by the Glucose Sugar Refining Company.

actual value was about $1,250,000.[1] The plant of the Rockford Sugar Refining Company was worth approximately $1,000,000 and that of the Davenport Syrup Company $300,000. The two plants of the Peoria Grape Sugar Company and the Firmenich Manufacturing Company were of little value. The former burnt down before it was assumed by the new organization. Certainly $250,000 would be a liberal valuation for these taken together. The $1,550,000 of working capital was largely absorbed in acquiring working assets. It would seem that $7,500,000 would fully cover the actual value of the plants and current assets acquired by the Glucose Sugar Refining Company.[2] Against this property the Company issued over $37,000,000 of stock, carrying cumulative dividends of over $900,000. The preferred stock sold immediately for $85 a share and the common

[1] The promoters of the Glucose Sugar Refining Company paid approximately $2,250,000 for the Peoria plant of the American Glucose Company. It was, however, in very poor condition with under-maintained machinery, neither modern nor economical in operation. As it was the largest glucose refinery, next to the Chicago plant, the promoters deemed its acquisition essential to the new consolidation in order to remove the plant itself and its owners from future competition. This is shown, indirectly, by the fact that in the purchase contract, Cicero J., William, and Harry Hamlin, who controlled the American Glucose Company, bound themselves not to engage in the manufacture of glucose within 1,000 miles of Chicago.

[2] The estimate given above is substantiated by indirect evidence. As the maximum capacity of the plants entering into the consolidation was 101,000 bushels daily, new, thoroughly-equipped plants of equal capacity could have been built for $10,000,000. All the plants entering the combination were antiquated; and some of them were badly equipped. During the first 10½ months, the average daily grind was 74,000 bushels. (Total operating capacity during first 10½ months, 20,616,816 bushels, 67 *Chron.* 272, an estimate corroborated by the estimates of individual plants, *infra*, p. 81.) This capacity could be attained by new plants of the most modern construction costing $8,000,000. Furthermore, a chemist of the American Glucose Company, later a chemist of the Glucose Sugar Refining Company for a time, one Ernest Mas, stated under oath that the plants entering the consolidation were worth $6,000,000. He stated that he based his estimate on his judgment as a chemical engineer. As a matter of fact this man's opinion should not be taken too literally as he had a grievance against the Glucose Sugar Refining Company at the time of making the statement for not continuing his regular salary. (1 *R. I. C.* 81.) The estimate given in the text above was not based on Mas's judgment. When, however, several independent lines of evidence point to essentially the same valuation of the plants, we are led to believe that the estimated value is approximately correct.

stock for $45.50 a share,[1] and by September, 1897, the preferred stock had risen to $95 a share and the common stock to $52.[2] On the basis of the average of these prices the Glucose Sugar Refining Company had a market valuation of $22,500,000.

The profits of the promoters are difficult to compute. To obtain approximately $3,000,000 in money, with which to buy some of the plants outright, and $1,550,000 to acquire the inventories of the various manufactures, the promoters formed a syndicate. The subscribers to the syndicate were given $100 in preferred stock and $142.85 in common stock for every $100 subscribed in money.[3] Such was the speculative fever of the time that a premium of 40% was offered for the subscription rights.[4] The syndicate itself called for the issue of $4,500,000 of preferred stock and $6,428,250 of common stock. In addition the promoters took approximately $3,000,000 in common stock for special fees, purchase money bonuses, lawyers' expenses, and the like. The promoter received directly a fee of $500,000 in common stock.[5] The indirect promotion profits were very large, but are difficult to compute as the net price of $17,000,000 in securities paid for the $1,250,000 stock of the Chicago Sugar Refining Company must be looked upon as consisting largely of promoters' profits to the Matthiessens and their associates.[6]

[1] 65 *Chron.* 327.

[2] *Chron. Inv. Sup.*, October 1897, p. 37.

[3] The money subscribed by the members of the syndicate was obtained mainly through the efforts of Norman B. Ream, a stockholder of the Rockford Sugar Refining Company. To this syndicate prominent New York financial interests subscribed, — J. P. Morgan and Company, $500,000; the Guaranty Trust Company, $250,000; Governor Flower, $50,000. The larger subscribers liquidated their allotments at the high prices at which the securities sold soon after the Company was incorporated.

[4] 65 *Chron.* 327.

[5] Joseph B. Greenhut had been promised an additional $500,000 in common stock for obtaining the money requisite to purchase the plants. At the time he was prominent in the affairs of the Whiskey Distillery Combination, about which Company there was considerable notoriety. The money was obtained instead by a purchase money syndicate described above.

[6] It was first planned to pay for the Chicago Sugar Refining Company's stock in money at the rate of $500 a share, or $6,250,000 in all. Subsequently it was

TABLE SHOWING DISTRIBUTION OF STOCK OF THE GLUCOSE SUGAR REFINING COMPANY

To Whom Issued	Location of Plant	Chief Stockholders	Cash	Preferred Stock	Common Stock	Rated Daily Capacity	Actual Daily Capacity
						Bushels	Bushels
Chicago Sugar Refining Company	Chicago, Ill.	F. O. and E. A. Matthiessen, family	....	$7,000,000	$10,000,000[1]	26,000	26,000
American Glucose Company	Peoria, Ill.	Hamlins	$2,250,000	.	..	26,000	23,000
Peoria Grape Sugar Company	Peoria, Ill.	A. J. Drake Estate Max Meyer S. and A. Woolner	....	500,000[2]	1,000,000[2]	15,000	(Burned)
Rockford Sugar Refining Company	Rockford, Ill.	J. W. Doane Norman B. Ream J. J. White	...	739,300[2]	2,000,000[2]	16,000	16,000
Davenport Sugar Refining Company	Davenport, Iowa	H. C. Andressen R. Krause Employees	700,000	....	...	9,000	7,000
Firmenich Manufacturing Company	Marshalltown, Iowa	Firmenich family	....	400,000[2]	1,400,000	9,000	2,000[3]
Cash Working Capital	....	....	1,550,000	...	....	101,000	74,000
Total Cash Subscribed	....	....	$4,500,000				
Syndicate Furnishing Cash: $100 in Preferred + $142.85 in Common for each $100 Cash	....	....	....	4,500,000	6,428,250		
Joseph B. Greenhut	....	....	....	....	500,000		
J. P. Wilson Levy Mayer } Attorneys (approx.)	....	....	....	....	1,200,000[2] 800,000[2]		
Special Commissions, etc., and bonuses to F. O. Matthiessen and N. B. Ream	....	....	....	....	698,950[2]		
Later issued to Geo. F. Harding in settlement of litigation	....	....	....	500,000			
Total Stock Issued	....	....	....	$13,639,300	$24,027,200		

[1] The Chicago stockholders were given securities on the basis of $6,250,000 cash for the $1,250,000 ($500 a share), computing the allotment on slightly better terms than as those upon which the underwriting syndicate acquired its securities.

[2] The amounts of stock marked [2] are approximate, but are believed, from various lines of evidence, to be substantially correct

[3] Actually no capacity until rebuilt at an expense of $300,000.

The table on the preceding page gives the approximate distribution of securities.

The preferred stock had an immediate market value of between \$85 and \$95 a share and the common stock of between \$46.50 and \$52.50 a share. Thus, using average quotations and omitting from the computation indirect promoters' profits through excessive purchase prices, it appears that the promoters and the underwriting syndicate had an immediate profit, based on market quotations, of \$4,500,000.[1]

The combination was promoted at a very auspicious time, at the beginning of the general expansion of business throughout the country. The glucose factories everywhere had been either closed or running on short time, so that there was but a small stock of goods in the hands of the consumers. As a result the new combination was able to operate its plants at practically full time, and to raise and hold the price of glucose at \$1.60 per hundred pounds. Frequently it was at even a higher level. In the preceding years of competition the price had been as low as 98 cents and had averaged a little over one dollar a hundred pounds. These unusually favorable conditions were reflected in the financial history of the Company. The regular quarterly dividend on the preferred stock was paid on the first of December, 1897, hardly three months after it had begun business. The first report, showing the operations of the combination for the first ten and a half months of its history, indicated a net profit, after writing off over \$1,000,000 for depreciation, of \$1,863,157. After paying the full 7% on the preferred stock there still remained nearly \$1,000,000 for the surplus account. All the omens pointed to success; and President C. H. Matthiessen suggested, unofficially, a dividend on the common stock perhaps

decided to issue new securities directly in exchange for the stock. For each share (\$100) of Chicago Sugar Refining Company's stock was given 5.4 shares (\$540) of the preferred stock and 8.2 shares (\$820) of the common stock of the Glucose Sugar Refining Company. (Option agreement of June 7, 1897.)

[1] The total amount of securities issued to promoters and members of the underwriting syndicate was \$4,500,000 preferred and approximately \$10,000,000 common stock. The average market value of the preferred stock was \$90; the common, \$49½, giving a total of \$9,000,000. The money furnished was \$4,500,000.

by "next November."[1] Nor were the stockholders disappointed. On December 1, 1898, a dividend of 1½% was declared on the common stock; and the securities were listed on the New York Exchange.[2] The initial quotation $108[3] a share for the preferred stock and $67 for the common stock represented a market valuation of over $30,000,000 for plants worth at most, $8,000,000, engaged in the manufacture of a staple commodity, unfortified by patents or special processes, and susceptible to the severest kind of competition. No considerable competition had, however, arisen. In the second year of its history, the Glucose Sugar Refining Company did apparently even better than in the first. After writing off $750,000[4] for the depreciation of their plants the Directors paid the full 7% on the preferred stock, 4½% on the common stock, and still had nearly $100,000 toward surplus. The third year the Company paid 6% on its common stock, and had over $270,000 surplus.[5]

From the first the Company was handicapped by two unfortunate circumstances, — expensive litigation and a mistake in trade policy. A stockholder of the American Glucose Company started a suit against that Company at the time of the transfer of its Peoria plant. The litigation was continued against the Glucose Sugar Refining Company. As a result the Company paid the stockholder to withdraw the suit and purchased the outstanding stock of the American Glucose Company. The total expense of this litigation, including the purchase of the stock and the lawyers' fees was approximately $1,200,000.[6] In addition the trade policy adopted by the President, on the advice of the promoter, was very unfortunate. As soon as the Company had been organized, he announced the payment of a rebate of twenty-five cents per hundred pounds at the end of six months to all customers who confined their purchase of glucose and grape sugar to the Company alone. The plan was

[1] 67 *Chron.* 273. [2] 67 *Chron.* 1263. [3] December 15, 1898.

[4] $772,490.44 — Listing statement to N. Y. Stock Exchange, A-2291. Also statement in 69 *Chron.* 541.

[5] 71 *Chron.* 808.

[6] $1,019,000 was paid directly for 12,323 shares.

put into execution in order to cripple the Company's competitors but in reality it created antagonism in the jobbing and candy trade and resentment among the managers of competing factories who sought in all ways to retaliate. After the policy had done considerable damage, and had stimulated, perhaps more than any other circumstance, the increase of competition, the Company withdrew the offer of a rebate within a year of its establishment.

It is the firm conviction of the present writer that exaggerated capitalization is very frequently a blessing in disguise from the point of view of the public. If dividends are not paid, the credit of the Company is low, and the fraud which was intended is defeated; if dividends are paid because of abnormally large profits, new capital is attracted to the industry, and competition reduces the profits down to or below the normal level. The glucose combination illustrates the second alternative of this rule. Toward the end of 1900, considerable competition had sprung up from various quarters; and, by the end of the following year, had assumed threatening proportions. The newly formed National Starch Company was increasing the production of glucose at its Waukegan plant; the Illinois Sugar Refining Company, a recently established competitor, had reached a capacity of 10,000 bushels of corn a day. Most serious of all, the Charles Pope Company had again entered the field. In the years before the establishment of the Glucose Sugar Refining Company, Pope had changed most of his product from glucose to bulk starch, where the profits seemed to be greater. So that in 1897, his presence in the glucose market was almost negligible. Soon after the management of the Glucose Sugar Refining Company had raised the price to $1.60 a hundred weight, Pope changed his production from starch back to glucose. He had been, in the years before, particularly successful in selling to the New England candy makers and by cutting the price of glucose to about $1.57 a hundred weight he was able to regain his position at the expense of the Glucose Sugar Refining Company. In 1901, further new and severe competition confronted the Company in the form of a modern refinery near New York

City. The New York Glucose Company was formed by certain men closely connected with the Standard Oil Company, and upwards of 60%[1] of its stock was controlled by that group. A glucose refinery, at Shadyside, New Jersey, opposite 106th Street, New York, was built and equipped with the most modern machinery. It had the capacity for grinding 20,000 bushels of corn a day. The enterprise was backed by men of great financial strength, and proved business ability.[2] Thus by the middle of 1901, the remunerative capacity of the competing plants was greater than that of the consolidation. From a control of approximately 85% of all the glucose refined in this country, the output of the Glucose Sugar Refining Company had declined in less than four years to only about 45% of the total operated capacity of the United States.

In the presence of all this competition the simplest principles of financial policy would have dictated the utmost conservatism on the part of the management of the Glucose Sugar Refining Company. The Company had no bonds; it was not burdened with fixed charges. On the other hand, the constituent plants when taken over were in very bad condition. Renewal and

[1] This estimate has been obtained from very reliable sources. The other stockholders were the Hamlins of the old American Glucose Company, President Nichols of the General Chemical Company and their associates. The stock of the New York Glucose Company was closely held.

[2] The formation of this Company illust ates the undercurrent of drama so frequently present in all these reorganizations. When the Glucose Sugar Refining Company took over the business of the American Glucose Company, at Peoria, the President, C. H. Matthiessen, who dominated the policy of the Company in all particulars, agreed with Wm. Hamlin to continue the employment of a certain superintendent at a high salary for a period of years. After the Glucose Sugar Refining Company was well on its feet Mr. Matthiessen concluded that the policy of the superintendent was not to his liking and dismissed him before the expiration of the time agreed upon. Much angry feeling was excited on both sides. Ultimately the superintendent and Mr. Hamlin, who was a close friend of the President of the General Chemical Company, induced Mr. E. T. Bedford and his associates in the Standard Oil Company to finance a new glucose manufacturing company which should build a thoroughly modern refinery in the East and compete with the Glucose Sugar Refining Company in all branches of the business. Mr. Bedford was desirous of establishing in business his son, then just graduated from college, and the Standard Oil Company was involved in a dispute with the Glucose Sugar Refining Company over a contract for oil.

improvement expenditures were absolutely essential to the continued success of the Company. The immediate duty of the management was clearly to improve their efficiency in order to decrease the net cost of producing glucose. Special attention ought to have been devoted to the economical recovery and utilization of the by-products. The methods of production at the various plants should have been systematized. The profitable years immediately following its organization gave the Company a liberal margin of surplus earnings with which to improve and reconstruct its plants without increasing its capital liabilities. Instead of following this course, however, the management chose rather the almost suicidal policy of declaring and maintaining dividends on both the common and preferred stocks.[1] During the first three years of the Company's existence no less than $5,100,000 was paid out in dividends. This represented an average of $1,700,000 a year dividends on property worth less than $8,000,000 — over 21%.

The liberal profits of the Glucose Sugar Refining Company, made during the first two years, could not long endure the effects of competition from without and decreased efficiency from within.[2] It was stated above, that during the third year, ending July 31, 1900, 6% was paid on the common stock, and a large surplus laid aside. This was the last prosperous year in the Company's history. During the following year competition had lessened considerably the margin of profit; and, although 6% was paid on the common stock, there remained, instead of a sur-

[1] The President of the Company was a man of little business experience, having been raised to the position through the heavy stock interests of his father and uncle. In absolute disregard of principles of business conservatism he proposed to declare a dividend on the common stock at the same time the initial dividend was declared on the preferred stock, and was detained from this action only by the protests of two older men, who were large stockholders.

[2] The decreased efficiency and petty and short-sighted economies by which the heavy profits were brought about are illustrated by an incident at the Davenport, Iowa, plant. An old-style tubular boiler was allowed to remain, and the management even cancelled the boiler insurance to save $2,400. About three months after the policy was cancelled, the boiler exploded, creating damage amounting to several hundred thousand dollars.

plus, a deficit of $272,673.[1] On the publication of this unfavorable report in October, 1901, the market value of the stocks of the Glucose Company fell rapidly from $109 a share for the preferred and $62 a share for the common in September to $99 for the former and $39 for the latter in November. The general market had advanced slightly during the period, so the decline in values was to be attributed solely to the Company's report. The quarterly dividend on the common stock was reduced in November from 1½% to 1%.

In the presence of this situation the President and the promoter of the Glucose Sugar Refining Company looked about for new supports to preserve the dominant position of the Company in the industry. It seemed to them that the solution of the difficulty would be found in another combination which should include the more important competitors. Especially was this feeling strong as the Company was then engaged in a suit with Charles Pope[2] covering certain processes connected with the manufacture of "thin boiling starch." Rumors of the plan of a further consolidation were circulated as early as the spring of 1901,[3] but the proposal was stoutly opposed by three of the Company's directors. Finally, in the winter of 1901–02, the President, Joseph Greenhut, and Joy Morton, of the National Starch Company,[4] were able to complete the details of the new consolidation which should include the Glucose Sugar Refining Company, the National Starch Company,[5] Charles Pope Glucose Company,[6] and a smaller but aggressive competitor, the Illinois Sugar Refining Company;[7] and should have substantial stock interest in the New York Glucose Company.[8] Under date of February 8,

[1] The deficit was shown after $124,320 had been charged to new construction in lieu of depreciation. The plants were carried on the books at over $36,000,000. This new construction was for rebuilding when severe losses had been sustained through fire. Apparently nothing was charged to the obsolescence of plant or machinery.

[2] *Supra*, p. 76.

[3] 72 *Chron.* 1190.

[4] *Supra*, p. 70.

[5] *Supra*, p. 64.

[6] *Supra*, pp. 76 and 78.

[7] Founded 1898.

[8] *Supra*, p. 85.

1902, a firm of New York bankers [1] sent to each of the stockholders of the Glucose Sugar Refining Company and the National Starch Company a circular letter offering to acquire their respective stock holdings in the interest of a new holding Company to be called the Corn Products Company.

The pivot of the succeeding reorganization was the control of the New York Glucose Company. It held the key to the situation. Although its refineries at Edgewater, N.J., had a capacity of only one-fourth those of the Glucose Sugar Refining Company, its equipment was of the most modern character and glucose could be manufactured there more cheaply than at any of the refineries of the consolidation. Moreover, the financial strength and business genius of the men behind the Company placed it in a commanding position. All this was clear to the President of the Glucose Sugar Refining Company who saw that a control of the industry would be impossible without the active coöperation of the New York Glucose Company. He therefore offered various of the stockholders of that Company a price for their shares far in excess of their cost and their book valuation.[2] Many consented to sell a part or all of their holdings on these terms and the President of the Glucose Sugar Refining Company was able to acquire, in the interests of the new Company, exactly 49% of the issued stock. He confidently expected to be able to obtain the 2% more, which would give him control. In this expectation he was disappointed.[3] Mr. Bedford and his

[1] Syndicate publicly managed by Cuyler, Morgan & Company.

[2] An agreement was signed whereby the New York Glucose Company agreed to convey 49% of its stock to the new consolidation, in exchange for $2,000,000 of new preferred stock and $2,000,000 of new common stock. Agreement of Jan. 27, 1902.

[3] There was much mystery concerning the details of acquisition of stock in the New York Glucose Company. It was told to the present writer, on the very best of authority, "C. H. Mattheissen stated repeatedly, in the presence of Attorney W. J. Calhoun that H. H. Rogers had promised to deliver 51% of the New York Glucose Company stock to the Corn Products Company, but when the time came to deliver he refused and denied the arrangement." That such an agreement existed appears doubtful, as the actual agreement, on the basis of which the stocks were transferred, called for only 49%. After having sold 49% of the stock to the new Corn Products Company, the comparatively few stockholders of the New York Glucose Company pooled the remaining 51%, transferring it to a holding company, designated as the General Trading Company.

associates, who held the bare majority of the stock, refused all offers. The management of the New York Company remained separate, distinct, and competitive.

The Corn Products Company was organized February 6, 1902, under the laws of New Jersey. It had a capitalization of $76,-000,000 of which $28,000,000 was 7% cumulative preferred stock, and $48,000,000 common stock. There was no direct bonded indebtedness, although the National Starch Company had something over $8,000,000 of outstanding bonds at an average of 5½% interest; and the New York Glucose Company's plant at Shadyside was mortgaged for $2,500,000 at 6% interest. These underlying obligations were neither assumed nor guaranteed by the Corn Products Company. The stockholders of the Glucose Company were offered $125, in new stock of a corresponding class for each $100 in old; those of the National Starch Company, $95 in the case of the preferred, and $90 in the case of the common stock.[1] This exchange required $20,874,710 of the preferred stock, and $32,370,435 of the common stock of the new Company, provided all the stockholders of the Glucose and Starch Companies should accede to the terms of exchange. It is obvious that the capitalization of the new Company can hardly be considered conservative even in the exchange of securities as the mere purchase of the Glucose Sugar Refining Company's stock alone involved an inflation of capitalization of upwards of $9,000,000. After assigning securities for the exchange of the stocks of the Glucose Sugar Refining Company and the National Starch Company there remained $7,125,200 of preferred, and $15,539,500 of common stock. Of these securities, $2,000,000 in preferred stock and $2,000,000 in common stock were given to the owners of 49% of the New York Glucose Company stock, who, on the basis of the market value of the new stocks, had secured a large profit.[2] And yet, despite this liberal recapitalization, the Corn Products Company had failed to obtain control of the most valuable of the new concerns, the New York

[1] Brief details in 74 *Chron.* 38.

[2] Many sold a part or all of their new stock immediately, as they had little confidence in the management of the Corn Products Company.

Glucose Company. The remaining securities, approximately $5,125,000 of preferred and $13,500,000 of common stock, were taken by the Cuyler, Morgan & Co. syndicate in exchange for approximately $5,125,000 in money. Of this amount $3,000,000 was expended in acquiring the Charles Pope Glucose Company [1] and about $725,000, or the equivalent in securities, in acquiring the Illinois Sugar Refining Company. The remaining $1,400,000 was given to the treasury of the Corn Products Company. Of this $970,583 was to be reserved as working capital.[2] The details of the exchange of securities and recapitalization are clear from the table given on the following page.

The justice with which the various security holders were treated can be seen best from an analysis of the operating capacities of the various factories acquired by the Corn Products Company and a comparison of this with the payments made. The Glucose Sugar Refining Company had not increased the number of its factories since its organization in 1897. It had suffered much from fires, but had rebuilt the Davenport and Marshalltown plants. Little had been spent in maintenance. The Company stated in the listing application to the New York Stock Exchange that the aggregate capacity of all its plants was 105,000 bushels of corn a day.[3] This was a gross exaggeration. During the first year, 1897–98, it was grinding at the rate of 74,000 bushels a day,[4] and at the time of the formation of the Corn Products Company at not over 65,000 bushels a day by the most liberal estimate.[5] The refinery of the New York Glucose

[1] The Charles Pope Glucose Company was acquired as the climax of a law suit concerning the infringement of patent rights. In settlement Charles Pope was paid $1,000,000 in money directly, and also $2,000,000 in money or securities. He agreed to retire from the glucose business for ten years. *Supra*, p. 87.

[2] $1,400,000 was subscribed, but $529,417 was used to discharge the bonded debt of the Illinois Sugar Refining Company. Apparently the Company received only $739,735.75 for working capital, the rest was used presumably for the expenses of organization. 1906 C. P. Co. Rep. 2.

[3] New York Stock Exchange Listing Application, A–2614, April 10, 1902.

[4] *Supra*, p. 79, note 2.

[5] It must be remembered that in reckoning the capacity of a mill one should take into account only such machinery as can be used with profit. Such capacity

FORMATION OF THE CORN PRODUCTS COMPANY

	Securities of Old Companies given in Exchange						Corn Products Company's Securities				
	Bonds	Fixed Charges	Preferred Stock	Contingent Charges	Common Stock	Ratio of Exchange	Underlying Bonds	Fixed Charges	Preferred Stock	Contingent Charges	Common Stock
Glucose Sugar Refining Company:						%	(Not assumed)				
Preferred Stock	....	....	$13,639,300	$954,751	....	125	...	....	$17,047,875	$1,193,351	
Common Stock	....	....	...	....	$24,027,300	125	....	....	....	....	$30,034,125
National Starch Company:											
Underlying Bonds	$3,002,000 1,000,000	$180,120 60,000	....	....	....	....	$8,139,000	$446,970			
Debentures	4,137,000	206,850									
Preferred Stock	....	....	4,028,300	241,698	....	95	....	....	3,826,835	267,878	
Common Stock	....	....	....	...	2 595,900	90	....	...	....	....	2,336,310
Charles Pope Glucose Company	....	....	...	....	120,000		...	....	5,125,200	358,764	13,539,500
Illinois Sugar Refining Company	....	....	....	....	750,000						
New York Glucose Company: Proportion assignable to the Corn Products Company 49% (Outstanding $2,500,000)	1,225,000	73,500	....	....	1,225,000				2,000,000	140,000	2,000,000
Totals	$9,364,000	$520,470	$17,667,600	$1,196,449	$28,718,200	...	$8,139,000	$446,970	$27,999,910	$1,959,993	$47,909,935

SUMMARY	Old	New	Change: Amount	Change: Percentage New to Old
Securities bearing Interest	$9,364,000	$8,139,000	−$1,225,000	87%
Securities bearing Fixed and Contingent Charges	27,031,600	36,138,910	+ 9,107,310	134%
Total Securities	55,749,800	84,048,845	+28,299,045	151%
Fixed Charges	520,470	446,970	− 73,500	86%
Fixed and Contingent Charges	1,716,919	2,406,963	+ 690,044	140%

[1] There was an underlying mortgage on the Refinery of the New York Glucose Company, but the proportionate indebtedness may be considered as offset by the cash contributed by the Underwriting Syndicate.

Company had a prospective capacity of 25,000 bushels. It was equipped with modern machinery for producing glucose at the lowest cost. The Charles Pope Glucose Company [1] and the Illinois Sugar Refining Company [2] were acquired for strategic purposes. Their remunerative capacities were at most 20,000 bushels. [3] Pro-rating half of the capacity of the New York factory it appears that the New York, Pope and Illinois companies conveyed to the Corn Products Company refineries having a capacity of 32,000 bushels, whereas those of the Glucose Sugar Refining Company had a capacity of approximately 65,000 bushels. The stockholders of the Glucose Sugar Refining Company received a little over twice the amount of new stocks that were assigned to the new interests. It would seem, therefore, that the distribution of securities between these two interests was fair.[4] A comparative estimate of the value of the National

has been called *merchantable*, or *remunerative*, in contradistinction to *rated* capacity which refers to the original maximum capacity. A comparison of the rated capacity of mills is of little value.

[1] Reference had been made before to the Pope Company, *supra*, pp. 76, 78, and 87. It had refineries at Geneva and Venice, Illinois, possessing together a rated capacity of 15,000 bushels a day. The Venice refinery had been, however, a failure from the beginning and the Geneva factory was entirely out of repair. The remunerative grinding capacity of the Pope Company was at most 9,000 bushels a day. It should be remembered that the large amount of $3,000,000 paid for the Pope Company was to remove the potential competition of Charles Pope and not primarily to acquire his refineries.

[2] The refinery of the Illinois Sugar Refining Company, at Pekin, Illinois, had been in operation less than two years. At an earlier time it was a beet sugar refinery. Its construction was antiquated and its machinery obsolete and out of repair. There was a rumor, neither denied nor affirmed, that the refinery had been started to harass the Glucose Sugar Refining Company and eventually be bought out. Its rated capacity was 20,000 bushels of corn a day. Its remunerative capacity was at most 11,000 bushels.

[3] It is stated in the New York Stock Exchange Listing Application (A–2614) that the joint capacity of the Pope and Illinois factories was 30,000 bushels. From very reliable evidence one may believe the estimate given above to be correct. Even 20,000 bushels is too large if measured by a standard of economical modern production. These plants were soon discontinued and subsequently dismantled.

[4] The New York Glucose Company had a mortgage on its refinery amounting to $2,500,000, the proportional part of which, assignable to the Corn Products Company, would be about offset by the syndicate's money and the working capital of the Pope and Illinois Companies.

Starch Company is more difficult. Its remunerative capacity was at most 20,000 bushels of corn a day.[1] Its box starch trade-marks, were, however, very valuable. Its plants were burdened by $8,139,000 of funded debt and the Company had outstanding commercial notes to an amount of over $1,200,000 in banks "from Denver to New York."[2] The Company was, in truth, on the verge of bankruptcy. In view of these facts the allotment of $3,800,000 of the preferred stock and $2,300,000 of the common stock of the Corn Products Company to the stockholders of the National Starch Company appears to be disproportionately large.

When looked at squarely, the financing of the Corn Products Company is an example of transparent stock inflation brought about by the stubborn short-sightedness of the management of the glucose consolidation, in the hope of inhibiting competition in an industry where competition was inevitable. Both the Glucose Sugar Refining Company and the National Starch Company had too large an issue of securities upon which interest or dividends were to be paid. This is clear in the history of the two Companies. The severe competition that confronted the Glucose Sugar Refining Company was not known to the great body of stockholders and the management desired, above all else, to let nothing be known that should affect unfavorably the market price of the Company's shares.[3] The National Starch Com-

[1] In the Listing Application to the New York Stock Exchange (A–2614) it was stated that the National Starch Company had a capacity of 43,000 bushels. Such an estimate took cognizance of plants long since abandoned and some of them dismantled. *Infra*, p. 102.

[2] Description of the condition of the National Starch Company from one intimately familiar with its condition in 1902.

[3] The New York Stock Exchange quotations are interesting as showing the relative market value of the constituent Companies, — February 9, 1902, — the day following the Cuyler, Morgan and Company's circular, —

Glucose Sugar Refining Company,	
Preferred	110
Common	48
National Starch Company,	
Starch Mfg. Co.'s 6's	109
Debenture 5's	92

pany had been unsuccessful, and was burdened by over $9,000,000 of debt. It can be readily understood, therefore, that a bonus of $25 in stock was needed to induce the Glucose Company stockholders to exchange their securities for those of the new Company; whereas it might be presumed that the Starch Company stockholders would be willing to exchange their shares at a discount. And if the rate of capitalization for the new Company was therefore reckoned on a basis of $125 for each share of the old Glucose Company's stock, it is apparent that the three smaller but conservatively capitalized companies could not be acquired except on the basis of a large purchase price which must be offset by a liberal stock issue, given either to the owners of the companies or to the members of the underwriting syndicate. The maximum merchantable capacity which could be assigned to the new Corn Products Company was at most 117,000 bushels of corn a day.[1] Refineries having the same capacities as those of the Corn Products Company could have been built in 1902 for approximately $12,000,000. If we allow, as we may fairly, the cash furnished by the underwriters to offset the relative proportion of debt of the New York Glucose Company attributable to the shares held by the Corn Products Company, it yet appears that including the underlying bonds of the National Starch Company, the Corn Products Company had outstanding at its organization over $84,000,000 of securities. Such was the confidence of the investing public, unaffected by reports showing rapidly decreasing earnings for the Glucose Sugar Refining Company, that the market value of the Corn

	Actual capacity starch and glucose	Nominal capacity as stated in the New York Stock Exchange Listing Application. A-2614.
Corn Products Company (1902):		
Glucose Sugar Refining Company	65,000	105,000
National Starch Company	20,000	43,000
Charles Pope Glucose Company	9,000	15,000
Illinois Sugar Refining Company	11,000	15,000
New York Glucose Company (49% of capacity)	12,000	
Total	117,000	
Competition (1902):		
New York Glucose Company (51% of capacity)	13,000	
Competitors	15,000	
Total	28,000	

Products Company was over $48,000,000,[1] four times the replacement value of thoroughly modern plants possessing the same capacity.

The formation of the Corn Products Company was more like the organization of a new Company, for the sake of eliminating competition, than the reorganization of an old enterprise. Before the consolidation the Glucose Sugar Refining Company controlled no more than 45% of the glucose refining capacity of the United States and was probably selling an even smaller proportion. After the consolidation the Corn Products Company had, including a proportionate part of the New York Glucose Company's production, upwards of 80% of the refining capacity of the country. To bring about this increased control both the capitalization and the fixed charges of the business were increased in the expectation of larger profits through a more monopolistic grasp on the industry. The expectation proved ill founded. Competition began to be felt, even within the first few months of the Company's existence. Piel Brothers, who had disposed of their old established business to the National Starch Company, built a starch factory in Indianapolis. Other glucose and starch mills sprang up in different parts of the country,[2] so that the Corn Products Company found itself obliged to sell its product with a constantly decreasing margin of profit.

Besides the growth of competition, another adverse factor was the high cost of corn. This increased the selling price of both glucose and starch and consequently decreased the demand.

[1] This estimate includes the market value of the National Starch Company's bonds.

Initial quotations on the New York Stock Exchange, March 20, 1902:

Corn Products Company

Preferred	$88
Common	34

The stocks were very active. Over 15,000 shares of the common and nearly 5,000 of the preferred were traded in during the first two days. The stockholders of the New York Glucose Company were, apparently, selling their holdings in the Corn Products Company. This belief is supported by collateral evidence.

[2] Piel Brothers, Indianapolis, 5,000 bushels, later 8,000 bushels; Warner at Waukegan, 20,000 bushels; Hubinger Brothers, Keokuk, 7,000 bushels.

The high price of corn reacted, also, to the detriment of the box starch business, since it was found impossible to decrease the size of the package, or increase the retail selling price, in obedience to the fluctuations in the price of corn. We have here an interesting instance where the stability and inelasticity of a "trade-mark" business militated against its success.[1]

The ill effects of competition and adverse trade conditions were not felt immediately, however. During its first year the Company reported gross earnings, after all expenses were paid, of over $4,000,000, out of which the Directors declared three regular quarterly dividends on the preferred stock, amounting approximately to $1,500,000. This left a net surplus for the year of over $2,500,000.[2] On the strength of this apparently remarkable showing the Directors declared an annual dividend of 4% on the common stock for the following year payable in four equal quarterly instalments. It was their intention to place the common stock on a regular dividend paying basis. But untoward circumstances began to make themselves felt during the second year. Fire destroyed a starch mill at Oswego, and, as has been said, the high price of corn aggravated the ill effects of the new and increasing competition. During the second year, ending February 29, 1904, the subsidiary companies set aside over $1,000,000 for new construction, in lieu of depreciation, but considering fire losses in Chicago and Oswego this amount was probably insufficient. As a whole the year's business showed a deficit for the Corn Products Company of over

[1] The Quaker Oats Company was confronted with a similar difficulty a few years ago, and has since decreased the size of the package. The new package is of the same shape, though smaller, so that only by comparison with the old package could the housewife determine that she was getting less cereal than before.

[2] Statement of year ending February 28, 1903, Corn Products Company:

Net profit for year	$4,013,841
Dividends preferred (5¼%)	1,426,066
Balance surplus	$2,587,775

1903 C. P. Co. Rep., summary, 76 *Chron.* 1083. Unfortunately no reference was made to depreciation charges, and subsequent revelations indicate that little provision was made. It should also be remembered that this was merely a "bookkeeping" surplus, in no sense a reserve of quick assets to be used if needed for the payment of dividends.

$2,200,000. The surplus of $2,500,000 resulting from the business of the first year was reduced to $350,000.[1] As soon as this was understood, the market price of the common stock fell to $10 a share. To counteract the ill effects of this statement numerous reasons were assigned to explain the unfortunate results of the year. The fires and the high prices of corn were duly emphasized, but the real reasons, inefficient management, unconservative financial policy, and vigorous competition were not mentioned.

The policy of the management, in declaring a full year's dividend on the common stock before the year had begun, is open to the severest kind of adverse criticism.[2] This policy was dictated by a short-sightedness to which, more than to any one cause, was due the financial blunders which attended the promotion and history of the Glucose Sugar Refining Company and were now casting their evil shadows on the fortunes of the Corn Products Company. One of the simplest business principles is that earnings can be estimated and dividends paid only after making adequate deductions for depreciation. Both the manufacture of glucose and starch involve rapid deterioration of plant,

[1] Statement for year ending February 29, 1904, Corn Products Company:

Net Income		$1,490,017
Dividend on Preferred Stock, 7%	$1,916,446	
Dividend on Common Stock, 4%	1,808,296	3,724,742
Balance for year, deficit		$2,234,725
Balance for previous year, surplus		2,587,776
Total balance		$353,051

1904 C. P. Co. Rep., summary in 78 *Chron.* 1905.

[2] The declaration of this dividend was most ill advised. The management had already seen the results of declaring common stock dividends in the case of the Glucose Sugar Refining Company. The excuse for this could not, therefore, be ignorance based on lack of experience. At the meeting of the Board of Directors, when the 4 % in common stock dividends were declared, Walter G. Oakman, then President of the Guaranty Trust Company, opposed the action and particularly the declaration of dividends for the entire year in advance. "The reasons advanced were those of a shrewd, far-seeing, keen banker, absolutely correct and just the way it came out. After he finished talking, the President asked him if he was through. He said, 'yes,' and without one word of reply to his statement the President put the motion for declaring common dividends and of course the dummy directors carried same." Statement of account of meeting of Board of Directors, given to present writer. The general accuracy of it has been checked from two independent sources.

and liberal allowances for the obsolescence of machinery. The management seemed to be ignorant of these simple facts, and fixed its gaze more attentively on the market value of the Corn Products Company's securities than on the permanent value of its property. An interesting commentary on the general policy followed by the management of these earlier companies may be gleaned from a printed remark of Mr. E. T. Bedford appearing after the reorganization of the Corn Products Company. "During the past fifteen years, three successive reorganizations of the industry have been rendered necessary, because of the payment of greater amounts in dividends than was consistent with the proper up-keep of the plants." [1] Moreover, in the direction of its business affairs, the management was arbitrary and short-sighted in the extreme, and seemingly ignorant of the complexity of modern business conditions. This is illustrated by his trade policy. Even as far back as the autumn of 1897, directly after the Glucose Sugar Refining Company had been promoted, the jobbers were antagonized by introducing the rebate system described in an earlier paragraph.[2] At no time were they friendly toward the organization. Soon after the Corn Products Company was formed the natural differences were disturbed in the price level of glucose. On account of the proximity of the western consumers of glucose to the corn belt, they possessed a slight natural differential over the eastern consumers and exporters. The men in the business had always recognized this fact. The Corn Products Company had little competition in the West; but in the East, the New York Glucose Company, 49% only of whose stock was in the treasury of the Corn Products Company, was marketing practically its entire grinding capacity of 25,000 bushels per day. It was especially strong among the New England candy manufacturers. To retaliate, the management cut the price of glucose in the East to a point below the price in the West. This embittered the western buyers, one of whom, a St. Louis manufacturer of preserves, built a glucose refinery

[1] Letter of E. T. Bedford, of April 30, 1910, to Corn Products Refining Company stockholders.

[2] *Supra*, p. 83.

of his own. To make matters worse the management antagonized the subordinate officials, four of whom at least withdrew with feelings of extreme anger and resentment.[1]

In the year ending February 28, 1905, no dividend was paid on the common stock of the Corn Products Company. The full dividend on the preferred stock was paid, but a part of the requisite money was obtained from direct borrowing from Chicago banks. Only $300,000 was charged to depreciation by the constituent companies, instead of $1,000,000 as in the previous year. Even so the business of the Corn Products Company had been conducted at a loss of over $200,000 and the book surplus of over $350,000 for the previous year had been reduced to a little over $126,000.[2] That same March, the dividend on the preferred was cut to 1%[3] and three months later, passed altogether.[4] In August of that year, at the instigation of certain large stockholders, the Company published a semi-annual statement which showed that the profits for the half year ending August 31, 1905 amounted to only $150,000, while the dividend of 1% on the preferred stock, declared for the period, required $273,790. The surplus of $126,000 of the previous February was reduced to a surplus of $2,510, this in a business the nominal assets of which were counted at over $73,000,000. In other words, a surplus of $2,587,775 arising from the business of the first year ending February 28, 1903 had been reduced through

[1] At the inception of the Company the President was the registered holder of 20,000 shares of the preferred stock. During December, 1904, there was transferred from his name 13,900. At the time of the reorganization of 1906 he was the registered holder of 3,700 shares.

[2] Statement for year ending February 28, 1905, Corn Products Company:

Net Income	$1,689,466
Dividends Preferred Stock, 7%	1,916,495
Balance for year, deficit	$227,029
Balance for previous year, surplus	353,051
Total balance	$126,022

[3] President C. H. Matthiessen issued a circular stating that action was due to the general depression in business and increased competition in the starch and glucose industries. 80 *Chron.* 1177.

[4] 80 *Chron.* 2623.

the payment of dividends to $2,510 during a period of two and a half years.[1]

Deep lying conditions were at the root of this rapid falling off of earnings. Neither the starch nor glucose businesses of the subsidiary companies were in a prosperous condition. The box starch business of the National Starch Company failed to show enough profits to pay even the interest on its bonds [2] and efforts were therefore made to scale down the Company's fixed charges. Nothing was accomplished. The management of the New York Glucose Company was increasingly aggressive and at the annual meeting of March 28, 1905, it was insinuated that severe and disastrous competition existed between the Corn Products Company and its precocious, but somewhat unruly foster-child. The New York Company had a thoroughly modern plant, capable of producing glucose at the lowest cost of any refinery in the country. When it developed that Mr. Bedford and his associates refused to give up their control severe competition ensued between the two organizations. As a result, at the close of 1904, the New York Glucose Company decided to conserve its assets, improve its plant and pay no dividends. In this way the Corn Products Company, owning 49% of the stock, was cut off from a very considerable source of income. The New York Glucose Company was not the only serious competitor. Other refineries of the most modern construction had

[1] Comparative Statement of Earnings of Corn Products Company

	Year ending Feb. 28, 1903	Year ending Feb. 29, 1904	Year ending Feb. 28, 1905	Six Months ending Aug. 31, 1905
Net profits	$4,013,841	$1,490,017	$1,689,466	$150,278
Dividends	1,426,066	3,724,742	1,916,495	273,790
Balance for year	$2,587,775	$2,234,725 (d)	$227,029 (d)	$123,512 (d)
Balance from previous year	....	2,587,775	353,051	126,022
Balance carried forward	....	353,051	126,022	2,510

[2] The discovery of a new process for making "pressed lump starch" accounted, to a large extent, for the decline of the National Starch Company profits. The old alkali process, used by the older Starch Manufacturing Companies' mills required about 50 days; the newer process, in use by the competitors, had reduced the time to 28 hours. In the older process not over 30 pounds of starch were recovered to the bushel of corn; the newer process enabled the manufacturer to recover 34 to 36 pounds.

been built in the middle West, refineries with a merchantable capacity of over 45,000 bushels of corn a day. This, with the 26,000 bushels capacity of the New York Glucose Company brought the capacity of the competitors of the Corn Products Company to over 70,000 bushels. Meantime the merchantable capacity of the Corn Products Company's mills had declined from 117,000 bushels, in 1903 to 60,000 bushels in the summer of 1905.[1] All but four of its mills were either practically closed or abandoned. In other words, the Corn Products Company was actually producing less than 46% of the starch and glucose manufactured in the United States. It is interesting to note that, beginning with the original National Starch Manufacturing Company in 1890, the proportionate control of each consolidated company declined rapidly after its formation. This is clearly seen from the table on next page.

Such conditions were not gratifying to a large body of the Corn Products Company stockholders, some of whom constituted themselves an investigating Committee. Little was achieved. The market price of the preferred stock fell, in August, 1905, to $40 a share and that of the common stock to $9 a share. The feeling of discontent with the management of the Corn Products Company, embittered undoubtedly by the President's arbitrary treatment of his associates, bore fruit during the latter part of the year, in a movement to retire the old management, replace it by the management of the New York Glucose Company and incidentally merge the two companies. The proposition amounted, virtually, to the absorption of the unwieldy and inefficiently managed Corn Products Company by its younger and stronger subsidiary, the New York Glucose Company. This became clear later, when, of the fifteen directors chosen for the new holding company, eight were men from the management of the New York Glucose Company. On the strength of this plan the market price of the Corn Products Company's preferred stock rose from $40 a share in August to $63 a share in December and the common stock from $9 a share to $21 a share.

[1] The proportionate share of the New York Glucose Company is included in the earlier estimate, but omitted from the second owing to the fact that the two companies worked at first in harmony with each other and latterly in opposition.

TABLE SHOWING COMPARATIVE CONTROL OF MARKET AT TIME OF SUCCESSIVE PROMOTIONS AND REORGANIZATIONS

	Date of Promotion	Merchantable Capacity owned or controlled by Combination at Time of Promotion	Merchantable Capacity owned by Competitors of Combination	Percentage of United States Output owned or controlled by Consolidation at Time of Promotion	Date of Reorganization of Consolidation	Merchantable Capacity owned or controlled by Consolidation at Time of Reorganization	Total Merchantable Capacity of Competitors of Consolidation at Time of Reorganization	Percentage of Total United States Output owned or controlled by Consolidation at Time of Reorganization	Merchantable Capacity of those Competitors taken into the New Consolidation at Time of Reorganization of Old Consolidation	Percentage of Competitive Capacity taken in at Time of Reorganization	Percentage of Total United States Output taken in at Time of Reorganization	Total Merchantable Capacity of the New Consolidation	Percentage of Total United States Output of the New Consolidation
National Starch Mfg. Co. (Starch)	1890	20,000	9,000	70%	1900	18,000	27,000	40%	17,000	63%	38%	35,000	78%
Glucose Sugar Refining Company (Glucose)[1]	1897	74,000	13,000	85%	1902[2]	65,000	80,000	45%	52,000[3]	65%	36%	117,000	81%
Corn Products Company (Starch and Glucose)[2]	1902	117,000	28,000	81%	1906[4]	60,000	91,000	40%	51,000	56%	34%	111,000	74%

[1] The estimates of this series of figures are based on glucose alone.

[2] The estimates of this series are based on both starch and glucose.

[3] As the Corn Products Company acquired 49% of the stock of the New York Glucose Company, the capacity of the latter company has been pro-rated on this basis.

[4] Between 1902 and 1906, the New York Glucose Company had become an aggressive competitor, so the ownership of 49% of its stock does not in 1906 indicate a pro-rata control of its capacity.

Students of finance are familiar with the fact that strong competitive forces, backed by marked business skill, are frequently in a position to dictate the terms of combination to a large corporation already in nominal control of its market. There is the well-known instance of the Union Tobacco Company, loosely organized by men unfamiliar with the tobacco business, but backed by the powerful (and unscrupulous) New York Traction financiers, which was able to dictate terms of consolidation to the American Tobacco Company, though that, even then, dominated the market for manufactured tobacco. The Consolidated Cotton Company, with a nominal capitalization of $21,000,000 but with inefficient management was practically taken over by the more efficiently managed Bay State Cotton Company with an outstanding capitalization of only about $1,000,000.[1] Generally speaking, in a consolidation of operating companies the acquisition of an efficient management is more important than the acquisition of plants. So in the present instance, the management of the New York Glucose Company was able to dictate the terms of consolidation. One condition was the retirement of the management of the Corn Products Company. Through a process of natural selection it had proved a failure.

By January, 1906, plans for the reorganization and merger were presented to the stockholders of the Corn Products Company. They provided for the formation of the Corn Products Refining Company with the same capitalization as the Corn Products Company. The stockholders of the older concern were asked to surrender one-third of their holdings, for the purpose of acquiring the 51 % of the stock of the New York Glucose Company and the entire assets of two smaller concerns, the Warner Sugar Refining Company and the St. Louis Glucose Company. The former[2] of these had a refinery at Waukegan Illinois, with a daily capacity of 17,000 bushels.[3] It was a Maine

[1] *Supra*, Chapter XIV.

[2] The refinery was controlled by C. M. Warner. *Infra*, p. 272.

[3] The New York Stock Exchange Listing Application, January 25, 1906, A-3192, gives a slightly greater capacity. The estimate given above is more nearly correct as it was derived from a direct and very reliable source.

corporation, organized October, 1903, with a capital stock of $3,000,000 and no bonded debt. The St. Louis Syrup and Preserving Company owned a refinery at Granite City, Illinois, and a short branch railroad. The capacity was about 8,500 bushels. The protective committee of the stockholders had divulged the fact that the various plants of the Corn Products Company were grinding only 60,000 bushels of corn a day. Adding to this the part interests of the Corn Products Company in the refinery of the New York Glucose Company, we may estimate the actual ownership of the Corn Products Company as representing about 72,000 bushels of corn a day.[1] Against these assets there were bonds aggregating $7,195,000.[2] The capacity of the New York Glucose Company's refinery, not pro-rated to the Corn Products Company was 13,000 bushels; that of the Warner Company was 17,000 bushels; and that of the St. Louis Company 8,500 bushels.[3] Thus the grinding capacity added by the merger amounted to 38,500 bushels.[4] These refineries had bonded indebtedness approximating $2,300,000. In the plan of merger, the stockholders of the Corn Products Company were allowed two-thirds of the stock of the new holding company, and the other interests one-third. The allowance to the former was excessive. Aside from the trade-marks of the box starch business, the value of which was largely offset by the high price of corn, the assets of the Corn Products Company,

[1] Taking the capacity of the New York Glucose Company as 26,000 bushels. In all estimates of *value* the capacity, equity, and liabilities of this Company have been pro-rated. In estimates of *control* the capacity of the New York Company has not been pro-rated.

[2] This figure is deduced from New York Stock Exchange application A-3192. Condensed in 82 *Chron.* 1321.

[3] Neither of these smaller concerns were as efficiently managed nor had plants of as improved construction as the New York Company.

[4] In the plan of consolidation, issued by a committee of the Corn Products Company to its stockholders, January 6, 1906, it was stated that the New York Glucose, the Warner, and the St. Louis "did about 50%" of the business of the country, which estimate agrees with that here given, provided the capacity of the New York Glucose is not pro-rated to the Corn Products Company. The estimate given above is based on pro-rating 12,000 bushels of the New York Company's capacity to the old Corn Products Company.

burdened by heavy underlying mortgages, were less valuable than those represented by the new interests. Had the stockholders of the Corn Products Company been required to relinquish half, instead of a third of their stock, the plan would have been more equitable. There were two reasons which led Mr. Bedford and his associates to accept the terms of consolidation. The value of the total amounts of securities offered them was large as compared with the actual cost of the New York Glucose Company's stock; the entire management of the new company was vested in their hands. This latter was a concession of great importance, for, in the actual working of the consolidation, the old officers of the Corn Products Company retired and those of the New York Glucose Company assumed their places. The stockholders of the Corn Products Company were the distinct gainers by the consolidation.[1] Their property was not actually

[1] Some even of the stockholders of the Corn Products Company pretended to consider themselves unfairly treated in the reorganization and alleged a conspiracy by E. T. Bedford and his associates, — whom the bill declared were " commonly known as Standard Oil people," — with the old directors of the Corn Products Company, to defraud the stockholders of the latter company of their property. The feelings that existed between the Presidents of the two Companies were hardly such as to have encouraged a conspiracy. Some of the allegations made in the bill were at least entertaining in view of the history of the combination. For example it was alleged that the stockholders of the Corn Products Company were discouraged as much as possible by such reports as would induce them to sell out or transfer their stock." The bill further declares, " from the beginning the Company has been subjected to attack by the Standard Oil Company. One method was the construction of a factory for the New York Glucose Company by Bedford and his associates. This method failed and it was then attempted to buy the stock of the Corn Products Company by depreciating the stock values, and by sales of large quantities of stock on different exchanges in large amounts, and buying it in again at a lower figure. The $50,000,000 of Common stock was cut down by false sales to one-tenth of its supposed value, while $30,000,000 of preferred stock was depreciated to one-quarter of its par value." This incident illustrates admirably the difficulty of effecting a fair reorganization without the aid of the courts and a judicial sale of the old company's property. There are always stockholders who consider themselves aggrieved. Most serious of all there are always hordes of speculators and unscrupulous attorneys who stand ready to bring suit against a company, ostensibly to obtain rights in the name of justice, but actually to compel the large corporation to buy its peace at secret and exhorbitant terms. In the present instance the fact that the Corn Products Refining Company was under the control of men connected with the Standard Oil Company was made much of in the public press, apparently to prejudice public opinion against the Company.

worth twice that of the new interests. On the contrary, had Mr. Bedford and his associates not come to the rescue at the critical time either a drastic reorganization or bankruptcy would have confronted them. Besides the preservation of their property they exchanged their inefficient management for that of Mr. Bedford trained as he had been in the directorate of the old Standard Oil Company, the most exacting school of business administration in the country.

Like all the preceding combinations in the starch and glucose business, this one was burdened by excessive capitalization, and heavy cumulative fixed charges. The details of the reorganization are seen in the table on the following page. Counting all its refineries, the Corn Products Refining Company had an extreme rated capacity of 235,500 bushels a day.[1] The actual merchantable capacity of the entire plants of the Corn Products Company amounted to less than half this amount, approximately 111,000 bushels. Considering the considerable fluid assets of the New York Glucose Company it is fair to estimate the actual value of the operating plants, the real estate of the unused plants, and the net quick assets of the companies comprising the Corn Products Refining Company as approximately $12,000,000. To this may be added $2,500,000 for the box starch trademarks, and $500,000 for the various terminal railroads.[2] This estimate of $15,000,000 is upheld by the letter of President Bedford to Speyer and Company, June 2, 1909. After expendi-

[1] Statement to New York Stock Exchange, of March 11, 1906, A-3192. The great difficulty with estimations of capacity lies in the fact that the rated capacity was much greater than the merchantable capacity. This estimate, presented to the New York Stock Exchange, took into consideration old mills long since abandoned. The actual merchantable capacity of all the mills of the Corn Products Refining Company was not far from 111,000 bushels daily capacity.

	Starch and Glucose, bushels daily capacity
Corn Products Company	60,000
Warner Company	16,500
St Louis Syrup Company	8,500
New York Glucose Company	26,000
	111,000
Competitors	40,000
Total merchantable capacity for United States	151,000

[2] Mr. Bedford, three years later, valued these terminals at only $330,000 — Printed letter, June 2, 1909, to Speyer & Co.

REORGANIZATION OF THE CORN PRODUCTS COMPANY

Formation of the Corn Products Refining Company

	Securities of the Old Companies					Corn Products Refining Company's Securities				
	Underlying Bonds	Fixed Charges	Preferred Stock	Contingent Charges	Common Stock	Underlying Bonds	Fixed Charges	Preferred Stock	Contingent Charges	Common Stock
Corn Products Company:										
Underlying Bonds	$7,195,000	$392,500	...	...	....	$7,195,000	$392,500			
Preferred Stock	...	..	$27,380,740	$1,916,651	....	...	..	$18,253,826	$1,277,768	
Common Stock	....	....	....	....	$45,215,505	...	...	....	....	$30,143,670
New York Glucose Company:										
Bonds	1,999,360	119,961	....	....	....	1,999,360	119,961			
Stock 51%	...	...	....	....	1,275,000					
Warner Sugar Refining Company:										
Stock	....	....	....	....	3,000,000	...	....	11,746,174	822,232	19,856,330
St. Louis Syrup and Preserving Company:										
Bonds	300,000	18,000	....	....	....	300,000	18,000			
Stock	....	....	....	....	1,200,000					
Totals	$9,494,360	$530,461	$27,380,740	$1,916,651	$50,690,505	$9,494,360	$530,461	$30,000,000	$2,100,000	$50,000,000

SUMMARY	Old	New	Change: Amount	Change: Percentage New to Old
Securities bearing Interest	$9,494,360	$9,494,360	....	100%
Securities bearing Fixed and Contingent Charges	36,875,100	39,494,360	+$2,619,260	107%
Total Securities	87,565,605	89,494,360	+ 1,928,755	102%
Fixed Charges	530,461	530,461	....	100%
Fixed and Contingent Charges	2,447,112	2,630,461	+ 183,349	108%

tures of considerable sums had been made for betterment, he asserts that the total assets of the Company were worth $22,567,750. Against these assets of $15,000,000 the Company had a bonded debt of $9,494,360.[1] Upon the remaining equity of $4,500,000, represented largely by trade-marks, the reorganization had placed $30,000,000 of 7% cumulative preferred stock, and no less than $50,000,000 of common stock. The fixed charges alone amounted to over $500,000 and the contingent charges to over $2,000,000 more. The earning of the full charges would represent an earning power of fully 16⅔ % on the Company's actual property. The first market quotations of the Corn Products Refining Company's stock were on March 29, 1906 when the preferred stock sold for $80 a share and the common stock for $25 a share. On the basis of these quotations the property of the Company had a market valuation of over $45,000,000 or three times its actual worth and the equity had a market valuation of over $36,000,000 or eight times its actual worth.

From the previous history of the Glucose and Corn Products Companies, it is clear that the business possessed no exceptional earning power, but depended solely upon the ability of the management to produce a stable commodity at a low cost. In other words we are dealing here with a manufacturing business operating under conditions of free competition. In view of this fact the Bedford management adopted a wise conservatism in its dividend policy. Although the new Company has earned the full 7% on its preferred stock, after allowing for depreciation and payments to the sinking fund of its bonds, only 5% has been paid, — the dividends in arrears accumulating at the rate of 2% each year. Soon after the Company was organized, the preferred stock was quoted at $85; in the panic of 1907 it fell to $46; and in the market inflation of 1909 it reached $93.50 a share. The price of the common stock has fluctuated in the neighborhood of $10 a share.

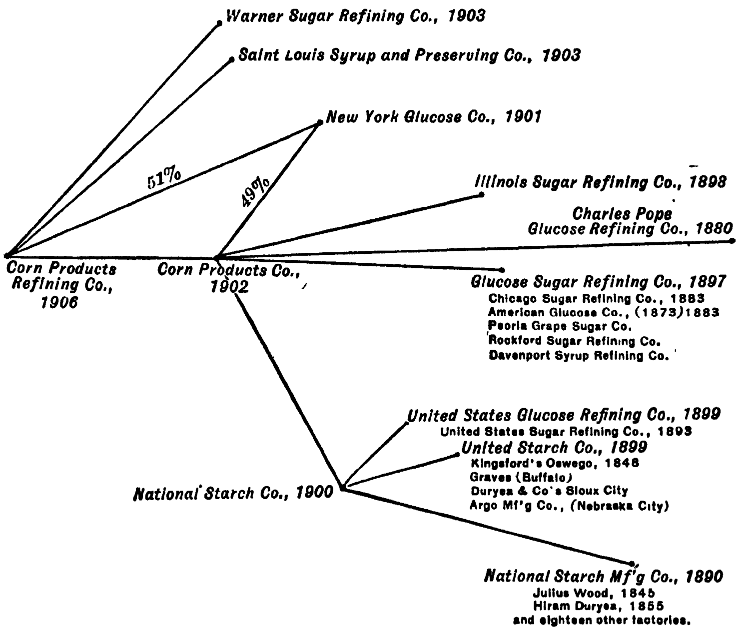
The methods of intensive efficiency and extension commonly used by the Standard Oil Company have been applied with

[1] Statement to New York Stock Exchange, A-3192. See table, *supra*, p. 107.

marked success to the Corn Products Refining Company. The management has recently entered into the manufacture of inexpensive candies and preserves, to insure a market for its glucose. It has placed before the public, " Karo Syrup " a widely advertised form of glucose, made palatable for family consumption. It has equipped a new and thoroughly modern glucose refinery near Chicago, built partly from earnings charged to betterments, and partly from the proceeds of the sale of an issue of $5,000,000 in bonds. The glucose business has been concentrated at Chicago, Pekin, and Granite City, Illinois, and Edgewater, N.J. All the subsidiary and previously existing companies have been completely merged, with the exception of the National Starch Company. The underlying bonds of the latter, upon which interest was defaulted, were exchanged for new debentures, guaranteed principal and interest by the Corn Products Refining Company on a basis of five new bonds for six old ones. These steps placed the finances of the subsidiary companies in better form. In the latter part of 1910, efforts were made to still further improve the financial condition of the Company, by reducing both the capital stock, and the contingent charges. Mr. Bedford's plan, which was thoroughly wise and far sighted, entailed the surrender of four-fifths of the common stock. The remaining one-fifth of the common stock and all the preferred stock was to be exchanged for new stock of one class, upon which it was proposed to pay dividends at the rate of 5% a year. The plan would have reduced the stock capitalization by one-half and done away altogether with the disparity of interests between the preferred and common stockholders. Unfortunately, the plan failed, frustrated by the same ideas which were responsible for the train of financial blunders that attended the fortunes of the subsidiary companies before the advent of the present management. The most elementary analysis of the Company's financial history shows the obviously imperative need of reducing its capitalization that the general credit of the Company especially of its bonds, shall be improved. Then, too, its general organization would be less pervious to attack on the ground of monopoly in restraint of trade.

Looking back over the history of the various component elements that have gone to make up the present Corn Products Refining Company we find nothing subtle and inexplicable in the succession of reorganizations. Both the early starch and the glucose companies were promoted under conditions of flagrant misjudgment based on the belief that consolidation would eliminate competition and increase conspicuously the margin of profit. Beginning with the reorganization of the National Starch Manufacturing Company there were no less than three reorganizations following in rapid succession, all based on the purpose of eliminating new competition as it arose through new and ever widening consolidation. The histories of all of these combinations, until we reach the last one, were very similar. The consolidated company started out with approximately four-fifths of the country's production directly under its control. Through high prices, which stimulated competition, and inefficient management, which prevented the consolidation from meeting the new competition as it arose, the proportionate control fell rapidly until it came to be less than a half of the country's output. At this point a new consolidation was effected. The results of this policy of reorganization to eliminate competition are seen from the table given on page 102. Finally, in the last reorganization, a new management came into control of the business which recognized the basic fallacy of the previous efforts to control the level of prices and to inhibit competition in a business where competition was inevitable. Success in such a business could result only from the efficient management of details, resulting in low costs of production and economy in distribution.

DIAGRAM SHOWING CONSTITUENT COMPANIES THAT HAVE ENTERED INTO THE FORMATION OF THE CORN PRODUCTS REFINING COMPANY



CHAPTER V

The Promotion and Failure of the National Cordage Company[1]

The antiquity of the industry, 113; early pools, 114; the National Cordage Association, 116; organization of the National Cordage Company, 117; expansion of the National Cordage Company, 119; increase of stock and public offering, 121; manipulation of hemp and buying competition, 125; financial operations, 132; failure, 135.

Chronological Summary

1861. First trade agreement.
1878. First pool.
1887. Incorporation of the National Cordage Company.
1889. Beginning of policy of expansion.
1890. Increase of capitalization and public offering of stock.
1892. Maximum control of the Company.
1893. Stock dividend of 100%.
Failure.

Our interest in the manufacture of cordage lies in the fact that here is to be found one of the first instances in which competing businesses united to form a large industrial consolidation for the sake of exacting monopoly profits. In its brief career the National Cordage Company illustrated almost every economic and financial problem that could ordinarily present itself in the history of any industrial consolidation. On the economic side it showed the gradual concentration under one control of upwards of ninety per cent of the American production in an industry where every condition favored competition. It dominated the market for the raw material and controlled as well the essential machinery used in the process of manufacture. To accomplish these ends every device was resorted to for creating a monopoly, — the "gentlemen's agreement," the pool, the legal trust, the leased corporation, and the holding corporation.

[1] For description of reprints of sources of information covering the National Cordage Company, see p. 164.

The financial history was no less varied. The common stock was issued to the promoters and the preferred stock to the public; the stock was marketed by a professional operator; officers of the Company participated in speculative "pools"; a stock dividend was declared on the basis of fictitious earnings in order to aid the speculation in the Company's securities. Unable to carry the burden of an oversupply of raw material and finished product, with its trade position undermined by new competitors, the consolidation collapsed in a day. Receivers were appointed and the Company was reorganized. All this occurred at the beginning of the panic of 1893, before the depression of the middle nineties, fully five years before the majority of our large industrial corporations sprung into being, and nearly ten years before the ill-fated among them had been reorganized. This early, one might say precocious, attempt on the part of the cordage manufacturers to create a monopoly gives the consolidation a particular interest for the student of economic history.

At the time of its strength, moreover, the National Cordage Company was a giant. The *Commercial and Financial Chronicle*, usually sparing in adjectives, referred to it as the "great industrial corporation."[1] It occupied the center of the stage, with the American Tobacco, the General Electric, and the American Sugar Refining Companies of minor importance. Powerful New York bankers were behind it. When, therefore, the whole house of cards fell to pieces in one crash, the collapse carried with it a disturbance and contraction of business confidence which contributed, more perhaps than any other single failure, to the acuteness of the crisis of 1893. After that time the reorganized Company led an uneven existence, reorganized and reorganized again, all the while diminishing in importance, until there remained hardly a vestige of its former prominence. Created originally to stifle competition, the consolidation was itself stifled by it.

The spinning of rope was among the first industries set up in colonial days. A rope walk was to be found in Boston as

[1] 56 *Chron.* 247, February 11, 1893.

early as 1642; and John Harrison was granted a monopoly by the Massachusetts Bay Colony, for his "rope field," to extend down to 1663. "In the federal procession of 1788, the men employed in the industry outnumbered any other class of mechanics in Boston." From Massachusetts, the industry extended to other colonies. A picture of New York, in 1728, shows "Tucker's Rope Walk." [1] In all this early period, rope making was dependent on the business of shipbuilding; so that, with the gradual decline of the latter industry, it became relatively unimportant. After the invention of the self-binding harvester machinery, a sudden impetus was given to the industry through the demand for binders' twine.

The first trade agreement among cordage manufacturers was consummated February 23, 1861.[2] The object was "to establish certain customs in the trade," correct abuses and misbranding, and to come to an understanding regarding prices. Weekly meetings were held in all the eastern cities where the cordage manufacture had secured a foothold. In July, 1874, the old agreements were entirely rewritten, and the "manufacturers pledged themselves, as men of honor and integrity, to the true and faithful observance of the rules." This proved ineffectual to prevent underselling, and the agreement was strengthened in 1875. Since this, too, proved of little avail as competition became stronger the manufacturers concluded to adopt a pooling system. The first pool was established January 1, 1878. A committee in conference with the manufacturers agreed that certain percentages of the total production of the country should be assigned to each manufacturer. "The percentages ranged from eleven and one-fourth per cent to one per cent." [3] When the business of a concern for a given

[1] Predecessor of the Tucker and Carter Company, one of the four chief constituents of the National Cordage Company.

[2] Much of the information in this paragraph was derived from *The Cordage Industry* by Benjamin C. Clark, Boston, 1895; a brief summary in eight pages, prepared for "The Memorial Centennial of 100 years of American Commerce."

[3] *The Cordage Industry*, by Benjamin C. Clark, p. 5. J. M. Waterbury testified before the Industrial Commission that L. Waterbury and Company had the largest percentage in the pool. XIII *R. I. C.* 127. As has become notorious in connection with the steel industry, price fixing and pooling agreements were frequently ar-

month exceeded the assigned percentage, that concern paid into the pool 2 cents a pound on the excess. The manufacturers whose production fell below their assigned percentages drew out from the pool 2 cents per pound on the difference.[1] "In 1880, the amount of the pool was reduced from 2 cents to 1 cent per pound, and in June of that year to $\frac{1}{4}$ cent; but in January, 1881, the pool was abolished."[2] Associations, conducted along the same lines, were formed in 1882 and in 1885. The last was to exist until February, 1888, but was broken up about a year previous, just before the organization of the National Cordage Company, on account of price cutting and false returns. Indeed, the reason for the failure of all these pools seems to have been that always some men would undersell their competitors, or make false returns to the organization.[3] There seems no doubt that competition was particularly severe during this period and the manufacturers regarded the agreements as means of mitigating its severity. Yet the ease with which they were broken up shows clearly that their influence was nominal. The pools controlled, however, a large percentage of the production,[4] and were probably able to reduce somewhat the amount

ranged at "dinners." For example Edwin H. Fitler gave a "banquet" to the trade at the consummation of the arrangements for the pool of 1885.

[1] An excellent account of the operation of such a "pool" is given by Henry Hudson in an account of "The Southern Railway and Steamship Association" which was operated among southeastern railroads, during this period. V *Quarterly Journal of Economics*, 70. Also reprinted in *Railway Problems*, edited by Wm. Z. Ripley, p. 98. See also, Hadley, IV *Q. J. E.* 158; *Bradstreet*, December 15, 1888; E. B. Andrews, "The late Copper Syndicate," III *Q. J. E.* 508.

[2] Clark, *The Cordage Industry*, p. 5.

[3] This generalization is also borne out by the testimony given to the Industrial Commission by various men (XIII *R. I. C.* 112–172) and by the reports that early cordage men gave to the writer in conversation. J. M. Waterbury testified, "They were always broken up by other new competition starting, or by some men not being willing to act up to the agreement." (XIII *R. I. C.* 126.)

[4] The production of cordage during the life of the United States Cordage Manufacturers' Association, the first pool, is seen from the following table. Statistics from Clark's *The Cordage Industry*.

	Pool
1878	46,661,000 pounds
1879	59,808,000 "
1880	70,480,000 "

These estimates averaged at least 70% of the total American output.

of cordage manufactured. They were hampered, and perhaps helped in a certain sense, by the enormous expansion in the cordage industry resulting from the manufacture of binder twine for the McCormick self-binding harvesting machinery.

In order to obtain the advantages of combined action four of the largest manufacturers formed among themselves two separate organizations, one a " trust " and the other a corporation. The first was an actual " trust " in the old legal sense of the word.[1] The owners of the stocks of the competing companies assigned them to a central board of " trustees," who issued certificates of proportionate interest or shares in the total property held by them as trustees. In this way the trustees had absolute control, as legal owners, of the subsidiary companies, yet these subsidiary organizations were kept intact as ostensibly competitive units. The legal trust was a logical development out of the " pool," when it was recognized that the managers of the pool had no legal control over the operations of its members. As trustees of the trust they were the legal owners of the property of the members, and could therefore administer each separate mill in the interest of the whole organization. In this case the trust was called the National Cordage Association. It controlled four separate companies. The L. Waterbury Company, with a mill in Brooklyn, was distinctly the largest single manufacturer of rope and twine in the country. It had been in profitable operation for years as an independent mill, and it entered the new combination with a large surplus and high commercial credit. Its financial rating was well above a million dollars. The Tucker and Carter Cordage Company was one of the oldest concerns in the business. In the early part of the eighteenth century, the great-great-grandfather

[1] The references on the old legal " trust " are numerous, see especially W. W. Cook, *Trusts*, 1888; G. H. Wald, "Two Recent Trust Cases," I *Har. Law Rev.* 201; F. J. Stimson, " Trusts," I *Har. Law Rev.* 132; T. W. Dwight, " The Legality of Trusts," III *P. S. Q.* 592; N. Heinsheimer, " The Legal Status of Trusts," IV *P. S. Q.* 190. For good description of the operation of a trust see J. W. Jenks, " The Development of the Whiskey Trust," IV *P. S. Q.* 296 (reprinted in *Trusts, Pools, and Corporations*, edited by Wm. Z. Ripley, p. 22). For later legal opinions see Boisot, 30 *Am. Law Reg.* 751; Dodd, 7 *Har. Law Rev.* 157.

of the then head of the Company was a shipping merchant, who started a rope walk in order to manufacture his own rope. In 1887, the mill was capitalized for only $500,000. Its business had permitted of thirty per cent in dividends, besides allowing upwards of $600,000 to be deflected into improvements. The W. Wall's Sons and the Elizabethport Cordage Company were old concerns quite as successful. It is true, therefore, that the cordage consolidation began its life with four well established, conservatively capitalized businesses, which had yielded high profits as separate organizations. These four companies operated 2,800 spindles and manufactured about thirty per cent of the rope and cordage produced in this country.[1] The Association had not the proportionate control over the industry that some of the early pools had had, owing to the fact that several of the largest manufacturers would not deed their mills to the trustees. All the Association's affairs were kept secret. After the American Sugar Refining and Standard Oil decisions,[2] the attorneys for the manufacturers advised them to give up the trust form of organization because of its doubtful legality. The advantages of combination had already been secured in the corporate form of organization.

The other means of combination was through a corporation in which the four manufacturing concerns had a joint interest. On July 20, 1887, the certificate of incorporation for the National Cordage Company was filed with the New Jersey Secretary of State. The Corporation was under the direct control of the four large cordage manufacturing companies referred to in the pre-

[1] The estimate given by J. M. Waterbury before The Industrial Commission was forty per cent to fifty per cent. (XIII *R. I. C.* 127.) It was excessive, however. In the latter part of 1891, a writer in the *New York World*, apparently conversant with the situation, estimated the spindle capacity of the country at 10,386. The checks available by the present writer at this time would indicate that this estimate is thoroughly reliable. The four mills just mentioned had 2,800 spindles. Allowing for the growth of competition in the meantime, we may estimate roughly the control of the four mills just mentioned, at the time of the early "trust" and the formation of the National Cordage Company in 1887, at thirty per cent of the country's production. This was the nucleus of the whole consolidation.

[2] People *v.* North River Sugar Refining Co., 121 *N. Y.* 582, 1890. State *v.* Standard Oil Co., 49 *Ohio St.* 137, 1892.

vious paragraph. Its authorized capital was $2,500,000 and the initial cash subscription was stated as $1,000,000. This was soon increased to $1,500,000. The Corporation was at first merely a legal device for enabling the members of the National Cordage Association, the "trust," to coöperate with each other in the purchase of hemp and sisal and in the sale of the finished rope and twine. The capital, contributed by the manufacturers themselves, was used to finance the purchase of raw hemp and sisal for the members of the Association and to assist in carrying the considerable load of floating debt always present in a seasonal business like that of the manufacture of binder twine. The Company was conceived as a convenience to help in the conduct of the manufacturing business, a financial prop to help maintain the control of the market secured by the Association. The stock was all held by the manufacturers themselves and none was placed on the market during the first three years of the Company's history. The Directors were men thoroughly familiar with the cordage business.[1] In fact promoters, bankers, and stock market interests were conspicuously absent during the early years of the National Cordage Company's history.

The practical common sense of the Directors of the Cordage Company is indicated by their method of conducting the business of the separate mills. Each one of the four manufacturing companies managed the operation at its own mills, while the organization of the National Company merely attended to the purchase of the raw material and the sale of the finished product. To stimulate economical production the Directors of the National required each operating company to bid a price at which it would manufacture for the central organization. In case the bid was not as low as that of the other subsidiary operating companies the unsuccessful competitor was required to close its mill at its own expense. This entailed considerable loss,

[1] James M. Waterbury, President, and Chauncey Marshall from the L. Waterbury & Company; Willard P. Whitlock and Elisha M. Fulton from the Elizabethport Company; Frank T. Wall from W. Wall's Sons; John A. Tucker and Caleb P. Marsh from Tucker and Carter. (Marsh had been hired by the Tuckers to look after their interests in the Cordage Association and the National Cordage Company.)

although the Company would, of course, derive an income from its interests in the National Company and the National Association. The lower the price at which the manufacturers were willing to spin the cordage, the larger the margin of profit between the raw hemp and the finished rope and twine, and incidentally the greater the earnings of the National Cordage Company. This method of preserving individual responsibility in the face of consolidation, of stimulating efficiency of personal attention to detail without relinquishing the economies of large-scale production, is possibly unique, and certainly worthy of careful consideration. Later, when the listing committee of the New York Stock Exchange were passing judgment on the securities of the Company they are said to have called it "a novel idea" and "a pretty sound scheme of consolidation."[1] "All the economies of consolidation are secured by this plan of organization, as well as the wholesome effect of free and keen competition among the manufacturers."[2] The fact that the Cordage Company discovered this device for solving some of the difficulties of concentrated ownership and control in the very earliest years of the combination movement is indeed worthy of note.

Stimulated by the success with which they were managing the four large mills, the Directors of the National Cordage Company conceived the plan of a combination of cordage mills which should exert a monopolistic influence throughout the industry. To this end the Directors leased for ninety-nine years the properties of the four large cordage companies, and used the $1,500,000 of money paid into the Company's treasury as working capital. In this way the National Cordage Company began to assume some of the functions of the Association, and to play, therefore, a more important rôle. It was to be the nucleus of a larger combination. Furthermore, the Directors began to negotiate for the acquisition of various small mills throughout the east and by the end of 1890 they controlled by lease or option ten small mills besides the four already in the

[1] Quotation of J. M. Waterbury's testimony. XIII *R. I. C.* 127.

[2] Belmont and Vermilye's Prospectus for the sale of the preferred stock, p. 3.

National Association. These mills altogether had a nominal capacity of upwards of 3,900 spindles.[1] The total operating spindles of the United States amounted in 1890 to something between 9,500 and 10,000. The first expansion of the National Cordage Company, therefore, gave it a nominal control over something like forty per cent of the rope and twine production of the country.

In the spring of 1890 three circumstances prompted a further extension of this policy on the part of the National Cordage Company. The first of these was the advice of the Company's attorneys that the old National Cordage Association, being of the nature of a trust, should not be continued. Much discussion was current concerning the Standard Oil and especially the American Sugar Refining trust cases, then pending in the Ohio and New York courts. The attorneys assured the Cordage Association managers that the same ends could be attained under a corporate form of organization. This corporate form could be supplied should the National Cordage Company take over the entire functions of the Association. The second circumstance that prompted an enlargement of the National Cordage Company was the desire of the Directors to secure a public market for the Company's securities, and thereby extend the business beyond the limits of their own capital which had been very much depleted by unfortunate speculations in raw hemp to be described presently. The public was not aware of

[1] Original four operating companies of the National Cordage Company: —

L. Waterbury & Co.	Brooklyn, N. Y.	900 spindles
William Wall's Sons	Brooklyn, N. Y.	500 "
Elizabethport Cordage Co.	Elizabethport, N. J.	800 "
Tucker & Carter Cordage Co.	Brooklyn, N. Y.	600 "

The ten mills acquired by lease or option during the latter part of 1889 and the early part of 1900: —

Xenia Twine & Cordage Co.	Xenia, O.	100 spindles
J. Rinek's Sons	Easton, Pa.	100 "
Akron Twine & Cordage Co.	Akron, O.	150 "
Victoria Cordage Co.	Dayton, Ky.	400 "
H. R. Lewis & Co.	Philadelphia, Pa.	100 "
Randall, Goodale & Co.	Boston, Mass.	100 "
Baumgardner, Woodward & Co.	Philadelphia, Pa.	50 "
G. C. Pooley & Sons	Buffalo, N. Y.	100 "
New York Cordage Co.	New York City (soon dismantled)	36 "
Altas Cordage Co.	New Orleans, La. (soon dismantled)	

List from Belmont and Vermilye Prospectus, and capacity from *New York World*, article quoted in 54 *Chron.* 34, January 2, 1892.

these circumstances and the Directors believed that the high financial standing of the four constituent cordage companies would enable them to sell the National Company's securities to the public. Whether or not the desire to recoup the treasury from the losses sustained by unsuccessful speculations was the primary motive that led to the extension from a private to a public corporation, it was at least incidental. In addition the Directors believed they could make a promoter's profit through the sale of the securities. The business community assumed in 1890, as it did in 1899, that immense profits could be made from the mere promotion of large industrial combinations. The third reason was the fever of extension then prevalent in the community and the belief that through a nominal control over the country's production of cordage the National Cordage Company could both exert a monopolistic influence on prices and also secure great profits from the economies of large-scale production. No expectations of profits through combination and trade monopoly seemed too extravagant in 1890. The first "boom" period of consolidation was at its height and in sympathy with it the Directors sought to acquire the actual ownership of the mills previously held through leases. As the floating debt was unusually large during certain times of the year, on account of the seasonal character of the business, investments in fixed assets could not be carried by means of bankers' loans. Extensions in the direction of purchasing real estate could be financed, therefore, only through the increase of capital liabilities. All these changes were alone possible through an increase in the capitalization of the National Cordage Company and an extension of its credit beyond that of the local bankers and note-brokers.

In the summer of 1890 the capital stock of the National Cordage Company was increased from $1,500,000 to $15,000,000, of which two-thirds was common stock and the other third eight per cent cumulative preferred stock. This latter was offered to the public[1] by August Belmont and Company and

[1] The public did not subscribe to the preferred stock to the extent that was expected. The Directors of the Cordage Company were compelled to take back a large part of the issue.

Vermilye and Company in an extravagantly optimistic prospectus dated October 9, 1890.[1] The common stock was divided about evenly among the original four companies and in addition some cash was paid to each, from the proceeds of the sale of the preferred stock.[2] With some of the money remaining from the sale of the preferred stock the National Cordage Company purchased outright the ten small mills which it already held under lease or option.

The actual value of these fourteen mills, as operating plants, can be estimated by indirect evidence. In the banker's advertisements, it was said that "the value of the assets," of the National Cordage Company inventoried August, 1890, "exclusive of the proceeds of the $5,000,000 preferred stock to be issued, is $12,000,000 and upwards, over and above all liabilities." [3] We therefore assume that the valuation of the promoters and bankers, whose judgment we have already quoted, placed an actual value of $17,000,000 on the fourteen mills, and all the quick assets then owned, or presently to be acquired, by the National Cordage Company. The capacity of these fourteen mills was 3,936 spindles.[4] Excellent modern mills could have been erected at the time for $500 per spindle. The working capital necessary to operate them would represent another $500 per spindle. Conservative figures would place

[1] Advertisement and announcement in 51 *Chron.* 491, October 11, 1890.

[2] For example, the Elizabethport Cordage Company received $2,397,300 in National Cordage Company common stock, and approximately $500,000 in cash. Balch *v.* National Cordage Company. Testimony of J. M. Waterbury before Commissioner C. N. Williams, October 17, 1892.

[3] Prospectus of Belmont and Vermilye, October 9, 1890, p. 3. Quoted also in 52 *Chron.* 279, and in Listing Application to New York Stock Exchange. The inventory was made by President Waterbury, the Secretary and three members of the Board of Directors. Why a banking house of the standing either one of these possessed consented to lend its name to the marketing of a stock of such unknown value is indeed a mystery. Nor indeed were the bankers guarded in their direct assertions. They state the results of the plant appraisals as based on affidavits "satisfactory to them." The striking difference in tone between this early circular and the prospectuses now published by bankers is deserving of note.

[4] Figures taken from writer in *New York World*, quoted 54 *Chron.* 34; January 2, 1892. From other evidence the present writer believes this estimate reliable. *Supra*, p. 120.

the reproduction cost at $1,000 per spindle,[1] including fixed and current assets. The actual value of the property of "going" mills of the most modern construction with a capacity of say 4,000 spindles, a half to two-thirds of which spun only binder twine, would not exceed $5,000,000. Mr. J. M. Waterbury, the first President of the National Cordage Company, admitted, in his testimony before The Industrial Commission, that the $5,000,000 of preferred stock "had some good-will in there."[2] Considering the antiquated character of some of the mills, and the considerable volume of current liabilities, it would be liberal to estimate the value of the property owned or soon to be acquired by the National Cordage Company, together with the proceeds of the sale of the preferred stock yet unexpended, as $4,000,000.[3] Against this property stood a capitalization of $15,000,000 upon which the Directors sought, — and succeeded for a while, — in paying eight per cent on $5,000,000 of preferred stock and twelve per cent on $10,000,000 of common stock. This represented an annual charge of $1,200,000 on assets worth less than $4,000,000, — over thirty per cent. And such was the belief in the economies to be secured by consolida-

[1] These figures were checked by the writer according to three independent lines of reasoning: (1) opinions expressed by cordage men; (2) cost accounts of "representative mills"; (3) the financial rating of (*a*) representative mills, and (*b*) nine of the mills that entered the combination.

Mr. Grimwood testified before the Industrial Commission in 1901, that the cost of erecting a 500 spindle mill was then $500,000 and that the working capital would be $250,000 more. XIII *R. I. C.* 113. This referred to a cordage mill, which is far more expensive than a twine mill, and a very large part of these mills then owned by the National Cordage Company were equipped only for binder twine. Besides, in 1890 construction costs were less than in 1901, and the machinery was built according to less expensive patterns.

[2] XIII *R. I. C.* 129.

[3] This estimate of $4,000,000 for the actual assets of the Company is amply large. Of the fourteen mills, two were immediately dismantled. All of the smaller mills had been acquired at inflated values. The net quick assets, which are considerable with any manufacturing mill, were largely offset by bank loans. The current assets had been much depleted by unfortunate speculations in hemp. From various indirect lines of evidence, the writer feels that $3,200,000 would represent a truer valuation of the mill property and cash assets. He prefers, however, to use the larger figure, to avoid any possible undervaluation of the Company's assets.

tion, that the market price of the common stock reached $140 a share in less than two years.

The purposes of the enlarged activity of the National Cordage Company, aside from the change from the trust to the corporation, were to force the stock of the Company into the hands of the public on the one hand and on the other hand to extend the business so that the Company might acquire a nominal control over the industry. The Directors sought to obtain the first object by means of a "stock pool." The preferred stock had already been put on the market by bankers. The common stock was divided about equally among the four original cordage concerns. It was then reassigned in February, 1891, to L. Waterbury and Company, the largest of the cordage companies, under what amounted to a trust agreement [1] for the marketing of the stock directly through the New York Stock Exchange.[2] The administration of this pool was placed in the hands of James R. Keene,[3] and several New York bankers became directly interested in the success of the pool. While Keene was making a market for the common stock on the Exchange the National Cordage Company's directors for whom, indirectly, he was acting, agreed not to sell any of their personal holdings not assigned to L. Waterbury and Company under the pooling agreement. As a result of Keene's activities and the subsequent financial statements of the Company, the market price of the common stock was forced up from $73 a share in March, 1891, about the time the pool began its life, to $142 a

[1] For example, certificate for 23,878 shares of the National Cordage Company's common stock, issued to the Elizabethport Cordage Company, February 24, 1891, was reassigned to L. Waterbury and Company on the same day, under the agreement. Balch *v.* National Cordage Company. Testimony before Commissioner C. N. Williams, October 17, 1892.

[2] Mr. F. K. Sturgis, of the present banking firm of Strong, Sturgis and Company, served as the intermediary who attended to the details of the arrangement. Later, at the solicitation of the banking interests, he became President of the reorganized company.

[3] It will be remembered that Keene was employed by the Morgan syndicate to market the United States Steel Corporation stock, some ten years later. He was also concerned with a speculative attempt to corner the United States Leather Company's common stock.

share in December, 1892. Early in 1893 the pool was liquidated and the profits divided. During this time the stocks of the Company were distributed among upwards of a thousand investors.

The other object which the Directors of the National Cordage Company hoped to attain through an enlargement of their Company was the actual control over the industry. To accomplish this end they became aggressive in three directions. They sought to control the market on raw hemp, they sought to control the manufacture of cordage-making machinery, and finally they sought to buy up all the competing cordage mills.

The market price of hemp is subject to pronounced and rapid fluctuations. At the time the Company was formed, in 1887, the price of manila hemp was about $7\frac{1}{2}$ cents per pound. It rose rapidly, reaching a maximum of 9 cents in the autumn of the same year. From this maximum it fell to $6\frac{5}{8}$ cents the following summer, and then rose rapidly again until, in the early spring of 1889, it reached 13 cents per pound, — the highest price until the time of the Spanish war. During 1889 and 1890 it fluctuated wildly, frequently varying 3 or 4 cents in the course of a single month. In January, 1891, the price of hemp stood at nine cents from which figure it sank slowly, but steadily, until the time of the failure of the National Company. This brief summary shows the unsteady character of the hemp market, an unsteadiness which invited manipulation on the part of the officers of the National Cordage Company.[1] When the cordage

[1] The following significant paragraph appeared in the *New York Times*, September 3, 1887: —

"Mr. Marsh, the Treasurer of the company, yesterday said that it did not pose as a monopolist, but it had secured the whip hand of its competitors, and it proposed to retain it as long as possible. 'Something had to be done,' said he, 'the quantity of machinery in existence was far in excess of the demand and there was not use for all of it. Somebody had to quit, and we determined not to be the ones if we could help it — and I think we have succeeded. Neither do we propose to pay any one for stopping. We have combined simply to reduce the cost of production to a minimum, and if any of our competitors are able to produce cheaper than we can now we will take a back seat and let them pick out the music. We do not propose to make excessive prices, but expect to make our profit in decreasing the cost of production. One thing we are satisfied of — we have all the raw

consolidation was formed, it acquired control of practically all the "spot" and "nearby" hemp.[1] The competitors had great difficulty in securing their raw material,[2] and the smaller ones were forced into selling their plants to the "trust." The National Company had practically a corner in hemp during the summer of 1887, and during the autumn and winter of 1888, but when it temporarily withdrew its artificial support in the spring of 1888, the Company lost heavily on the whole transacation. Mr. Marsh, the Treasurer, had anticipated that the heavy purchases of the Company would maintain the price. He failed to see that this would require the Company to absorb the entire supply of hemp and sisal at a level of prices which would so increase the cost of cordage as to curtail the demand and therefore defeat the very end the Company had in view. The first unsuccessful experience was not sufficient, and when the prices of raw hemp and sisal fell to low levels in the autumn of 1888, the Company tried again to artificially fix the price. Again it was unsuccessful and suffered severe losses. While engaged in this manipulation the Company sought to strengthen its position in the raw hemp market by means of agreements with jobbers. The Directors of the Company induced the five firms in Manila, that completely dominated the raw hemp market, to agree not to sell to any American manufacturer except the National Cordage Company. The contract also stipulated that these five concerns "would not sell any house in England manila hemp, unless that house in turn agreed that they would not sell to anyone in this country except at an advance of over half a cent a pound above the price we (National Cordage Com-

material, and I can't really see how other people are going to manufacture Cordage without Sisal or Manila.' When asked how prices had been affected by the combination he replied that some prices would be a little higher in sympathy with the rise in the prices of the raw material, but those prices were abnormally high just now, and he added with a twinkle of satisfaction in his eyes, 'There is no immediate prospect of a tumble in the price of either.'"

[1] In the case of certain small manufacturers who happened to have considerable supplies of raw hemp and rope, the National took them off their hands at inflated prices.

[2] William W. Fitler testified before the Industrial Commission of the difficulty in securing hemp during these years. XIII *R. I. C.* 147.

pany) were paying." [1] The agreement fell to pieces [2] in about six months; but during the time it lasted, the National Company was at a great advantage over its competitors. Even without any such contract it will be observed that the Company, controlling as it did a large part of the demand for raw hemp, could effectually raise or depress the price by coming forward or withdrawing from the market. It chose all along to raise the price. Finally during 1891, in a constantly falling market, the National Cordage Company purchased very large quantities of hemp for future delivery. These purchases were carried on in the name of "the National Syndicate," and its accounts were recorded in "a small black book without a name," [3] elsewhere alluded to as "the private ledger." These speculative transactions were undertaken at the instigation of certain of the Directors, and the losses sustained by the National Cordage Company, through the operations of the National Syndicate, were paid back to the Company by the Directors.[4] There is additional evidence to show that the Company embarked on other speculations in hemp in the early part of 1892 and in the autumn endeavored, unsuccessfully, to obtain a corner in the raw sisal market.[5] In all these transactions it suffered severe losses, and there is no evidence to show that the Directors who were responsible for the losses reimbursed the treasury of the Com-

[1] J. M. Waterbury, XIII *R. I. C.* 131.

[2] English jobbers were advised that the contract could not be enforced in common law.

[3] Affidavit of Ernest B. Balch, on motion for further examination of books of National Cordage Company. Heard before Chancellor McGill, July 24, 1893. The following very pertinent passage occurs in the Report of the Reorganization Committee, — "The Committee find, on examination of the accounts, that prior to October, 1891, sundry operations in merchandise, of a more or less speculative character, and not likely to occur again, were made, which resulted in loss to the Company." Reorganization Committee Report, June 15, 1893.

[4] Contract between National Cordage Company and the National Syndicate, dated October 31, 1891. The return of the losses is directly referred to in an entry in the National Cordage Company's principal ledger. "Loss assumed by the National Syndicate, in accordance with terms of contract, dated October 31, 1891, and a resolution of the Board of the same date." This transaction is also alluded to by the Reorganization Committee in their report of June 15, 1893.

[5] Letter from Dr. A. M. Cole, Akron, Ohio, May 5, 1893.

pany. Briefly then, beginning soon after the incorporation of the Company in 1887 down to its failure in 1893, the Company had sustained only losses in its speculations in raw material.

To establish a virtual monopoly in the manufacture of cordage the National Company entered into contracts and agreements with various cordage machinery makers in the United States and in England. The contracts amounted to an agreement on the part of the National Company to pay the machinery men large sums each year, in return for which they agreed not to sell cordage machinery to the competitors of the Company. The most considerable contract of this kind was executed with one John Good, especially known in the industry as the inventor of the "fast and slow gill chain" machinery for laying hemp. Good had been a machinist in the employ of the Tucker and Carter Company at the time he was working on the invention. Subsequently he started to manufacture his patented machinery, and in addition built a rope mill where it was used. This mill was the largest competitor of the National Cordage Company in New York City.[1] An agreement was entered into between the National and the Good Companies whereby the former agreed to pay the latter a sum of $200,000 each year, in consideration of which the Good Company agreed not to operate its cordage mill, not to sell any of its patented machinery to any of the National Company's competitors and finally to stop all infringements on its patented machinery.[2] A similar exclusive agreement was made with other manufacturers of cordage machinery, notably W. C. Boone, Jr., who, with his father and grandfather, had manufactured rope laying machinery for over fifty years.

The most extensive and far reaching undertaking which the officers of the National Cordage Company took upon themselves was the acquisition or control of competitive rope and twine

[1] Balch *v.* National Cordage Company. Testimony of J. M. Waterbury.

[2] Good also gave the Cordage Company an option on his entire machinery and cordage business. The option called for the payment of "several millions." Current rumors stated the amount as $7,000,000. Contract between Good and National Cordage Company dated November 2, 1891.

mills.[1] In pursuit of this end the Company adopted three different courses. After paying for the ten mills acquired before the autumn of 1890 with the proceeds of the preferred stock issue, the Company had not enough money in its treasury to purchase numerous other mills outright. At first the Directors followed the plan of buying the equity in mills, giving to the sellers a mortgage for a large part of the purchase price.[2] The second method of acquisition was by means of a finance company. During 1891, the National Cordage Company acquired many mills of varying capacities. Eight[3] of these were taken over by the Security Corporation at high valuations.[4] This Company acquired the cash to pay for these mills through the issue of $6,000,000 of bonds, and then leased them to the National Cordage Company in consideration of an annual rental of $360,000, and an annual sinking fund payment of $225,000. The National Cordage Company guaranteed the payment of the interest and the principal of these bonds. The rental took

[1] President Waterbury used to call these expenditures "buying competition." One mill, in Pennsylvania, was prepared for the purpose, with wooden painted shafting and nicely painted, but useless machinery. It might have cost $5,000 to prepare the hoax; the officers of the National Cordage Company paid $180,000 for it. (Authority of conversation with an old member of the National Cordage Company).

[2] Testimony of J. M. Waterbury, XIII *R. I. C.* 130. Also stated by Secretary Marsh, 53 *Chron.* 325. Clearly shown, also, in the revelations at time of failure, in 1893.

[3] Boston, Standard, New Bedford, Laurence, Middletown, Chicago, Ohio, and American (Field). Reorganization Circular No. 2, November 20, 1893. First public announcement of this finance corporation, 53 *Chron.* 713.

[4] There seems little doubt but that these "Security mills" were little more than "cats tails," as Forbes expressed the Burlington branches built for the purpose of being bought up. The Standard and Boston mills had been established by a prominent Boston manufacturer. Some time before they were acquired by the Security Corporation, they were united under one corporation with a capitalization of $1,500,000. The Directors of the National paid (judging from estimates of men connected with the two companies at the time) two or three times what the mills were worth at a liberal valuation. Part of the purchase money was in the common stock of the National Cordage Company. Whether this common stock was acquired through the Keene "pool" or from the cordage interests who originally received it, does not seem clear from the evidence at hand. Altogether the equity of these security corporation mills was estimated by the Receivers of the Company, less than two years later, at $163,447, the mere value of machinery, as second hand equipment. The cost of these properties had been over four million dollars. (Summary of Receivers' valuation in 57 *Chron.* 764.)

care of the interest, and the sinking fund would retire them at maturity. In this way the National secured the nominal ownership and actual control of the mills, without issuing its own securities.[1] Yet, relieved of its form, the existence of the Security Corporation involved nothing more than a device whereby the National Cordage Company could issue bonds without disobeying its contract with its own preferred stockholders which provided that the Company should incur no bonded liability.[2] It is indeed surprising that the preferred stockholders and the bankers who offered the preferred stock to the public did not attempt to prevent this method of financing. Some of the preferred stockholders actually did object to the plan on the ground that it impaired the strength of their security.[3] The third method of acquiring control of the mills was through price agreements and stock ownership. The former device was pursued with the John Good Company's cordage mill in New York, as previously stated, and with Fitler and Company in Philadelphia.[4] In the cases of corporations not amenable

[1] Further particulars of this financing were something as follows: The Security Corporation was organized under New Jersey laws, for the express purpose of taking title to the additional smaller mills. It leased these mills to the National Cordage Company for a term of twenty years, from November 1, 1891. The stock was held in the treasury of the National Company and by its officials. For the payment of the mills, the Security Company issued $6,000,000 six per cent First Consolidated Mortgage Gold bonds, due November 1, 1911, secured by mortgage to the Manhattan Trust Company covering the mills and the benefits of the lease. These bonds were guaranteed principal and interest by the National Cordage Company. Of the six million dollars of bonds, $1,790,000 were reserved to retire prior liens, and the remainder $4,210,000 were listed on the New York Stock Exchange. (See 54 *Chron.* 643.) An attempt was made through one B. L. Smyth and Company to advertise and sell these bonds to the public. Few of them, however, got out into the hands of the public. Nearly all were carried by the cordage men, on a twenty-five per cent margin, with New York bankers.

[2] "The creation of any bonded debt, except with the consent of holders of record of at least eighty per cent of the preferred stock is prohibited by by-law." Listing Application, New York Stock Exchange; Summary in 52 *Chron.* 279, February 14, 1891.

[3] "As I understand the matter, the Security Company's bonds have added to the liabilities of the National something like $6,000,000 in addition to its fifteen millions of stock." Balch *v.* National Cordage Company. Testimony of E. B. Balch, September 26, 1892.

[4] A trade agreement was probably consummated with Fitler and Company, of Philadelphia, who operated a 600 spindle mill, of modern construction. Such an

to such trade agreements, the men in control of the National Cordage Company sought to acquire a controlling stock interest. Large blocks of stock of the Plymouth Cordage Company were acquired in this way.[1] By these various means[2] the National Company increased its control of the cordage production from forty per cent of the country's output in October, 1890, to eighty per cent by December, 1891. Through agreements with rival manufacturers, its actual control amounted, in January, 1892, to ninety per cent of the output[3] of all the rope and cordage mills of the country.[4]

agreement is asserted in 54 *Chron.* 34, January 2, 1892, and in Mr. J. G. Taylor's testimony, although denied by William W. Fitler. XIII *R. I. C.* 147, 163. The two companies worked in harmony with each other from the first. All evidence, other than that noted above, indicates that at least a gentlemen's agreement existed between the two companies.

[1] The Cordage Directors, in their own interest and in the interest of the Company, had secured almost a majority. This was carried for them by a Boston banker on a twenty-five per cent margin. A large part of the Plymouth stock had been acquired through the estates owning the New Bedford Cordage Company when the latter was bought. It was deemed very important to secure the control of the Plymouth, as Waterbury understood from Drexel, Morgan & Company that they would back the consolidation in that event.

[2] Those concerns it could not control The National Cordage Company sought to ruin. One example illustrates their method. There was at that time a successful cordage jobbing and manufacturing concern by the name of Travers Brothers Company. It also conducted a hammock manufactory on Fifty-Second St., New York City. When the officers of the National found it impossible to buy the Travers business, they established a hammock factory one block away and sought to induce the Travers employees to take work in the new establishment. They also started the manufacture of cotton twine specialties in direct competition with similar products made by the Travers Brothers.

[3] These estimates are based on the assumption that the mills of the country had altogether a capacity of 10,000 spindles.

National Cordage Company

	Spindles	
Acquired in 1887	2,800	
Acquired before Oct. 1890	1,136	
Acquired between Oct. 1890 and Dec. 1892	4,050	
Number directly controlled		7,986
Controlled through agreements (approx.)		1,000
Approximate control		8,986

This information was obtained from the *Commercial and Financial Chronicle*, quoting the *New York World*, 54 *Chron.* 34, January 2, 1892. Other evidence obtainable by the present writer indicates the essential correctness of these estimates.

[4] In September, 1891, the Secretary of the National Cordage Company made

At first, the financial condition of the National Cordage Company seemed to foretell unusual success. In the statement for the business of the first year of the consolidated Company, ending October 31, 1891, the report showed a book surplus of over $3,000,000, and a profit on operations for the year amounting to $1,406,313.45. Out of this, eight per cent was paid on the $5,000,000 of preferred stock, and nine per cent on the $10,000,000 of common stock. In the meantime the stock pool under the able management of Keene had secured a wide market for the stock of the Company. It became the leading industrial security dealt in on the New York Stock Exchange.

Some time during the autumn of 1892, a prominent member of the New York Stock Exchange said to President Waterbury,[1] "Your stock is selling too high," meaning that, for speculative purposes, it would be better to have the stock selling at $70 a share rather than $140, even though the capitalization had to be doubled. This was especially important as the Keene pool was about to be liquidated and a new pool formed. It was essential for the success of the second pool that the prices of the stock should be well maintained. Accordingly President Waterbury presented the idea to the Board of Directors, who decided to issue, in January, 1893, a one hundred per cent stock dividend. The book value of the subsidiary plants was marked up to correspond with the inflation of the capital assets. The common stock was increased from $10,000,000 to $20,000,000. At the time, the Directors stated that the new issue was to be given stockholders "to represent about $11,000,000 of assets acquired by the Company since its formation, and which it is the policy of the Company to hold intact." Simultaneously the Company stated it would be its policy "at the end of the first fiscal quarter after the distribution of the new stock," to declare dividends equivalent to ten per cent on the preferred and seven per cent on the new common stocks. Following this state-

the following statement, "The National Cordage Company is thus nearing the goal that it originally set out to reach, namely the acquisition of all the mills in the country." 53 *Chron.* 325, September 5, 1891.

[1] As the man is now prominent, the name is withheld, at the request of Mr. J. M. Waterbury.

ment came the publication of the second annual income account for the year ending October 31, 1892, showing a net profit of $2,710,749, out of which $1,367,063 was carried to surplus after the payment of the full dividends on both classes of stock.[1]

The maximum influence of the National Cordage Company was probably attained in the spring of 1892. At that time its position was dominant in the market both for raw hemp and manufactured cordage. Nothing had occurred to undermine this position. But in the summer and autumn of 1892 the props began to slip. The Good patents for the "fast and slow gill chains," upon the basis of which Good had entered into his monopolistic agreement with the National Cordage Company, were decided not original by the courts, another manufacturer having brought to light an English patent of previous date. Accordingly in May, 1892, the National Company broke off[2] its contract with Good and the latter established a new corporation, backed by men closely allied with the First National Bank in Brooklyn. On October 31, 1892, W. C. Boone, Jr., the other prominent manufacturer of rope laying machinery, severed his exclusive contract with the National Cordage Company. Other manufacturers of machinery with whom the Company had an understanding or agreement followed suit.

The weakest point of the combination was its inability to control new competition. As rapidly as the officials of the Company would "buy up" the competing mills, the old owners either in their own name or as representatives of others, would start to build new mills. This process is admirably illustrated by the experience of the National Cordage Company in the Ohio field. The details are worth recording as indicating the inherent difficulty of acquiring a monopoly of production in an industry where economic conditions favor free competition. In the middle of 1891 the National Cordage Company acquired the Miamisburg Binder Twine and Cordage Company of Miamis-

[1] 56 *Chron.* 247.

[2] Good tried to make out that the cancellation of the agreement was due to him. (Interview, *New York World*, April 27, 1892.)

burg, Ohio, at the fictitious valuation of $185,000.[1] The Miamisburg Company had been selling binder twine to an agricultural implement firm by the name of Hoover and Gamble. In November, 1891, Hoover and Gamble organized the Miamisburg Cordage Company to manufacture binder twine, and engaged the mill superintendent of the old Miamisburg Binder Twine and Cordage Company. Early in 1892 the National Cordage Company, through a subsidiary, acquired the second Miamisburg Company from the Hoover and Gamble interests for $130,000. This was equally exorbitant. In May, 1892, some of the old stockholders of the two companies organized the Miamisburg Twine and Cordage Company, and with the proceeds secured from the sales of their stocks to the National Cordage Company built a new mill with which they began to compete with the National Cordage Company in the binder twine branch of the industry. At the same time the Hoover and Gamble interests added the manufacture of rope and cordage machinery to their harvesting implement business, prompted by the difficulty independent twine manufacturers were having in obtaining equipment. To attend to this part of their business they employed the two executive officers of another cordage mill previously acquired by the National. At the same time the Hoover and Gamble interests formed the Northwestern Cordage Company, which built a larger binder twine mill in St. Paul. This experience in Miamisburg was by no means exceptional. The purchase of the Sewall and Day mill in Boston for $800,000 merely stimulated the formation of the Ludlow Cordage Company, by several of its large stockholders. The purchase of the Suffolk Cordage Company merely prompted its President to build a mill in Newburyport, ostensibly for his son. Agreements not to engage in the cordage business were broken by the simplest subterfuges, so that instead of acquiring control of competitors the National Cordage Company found that its policy actually resulted in stimulating competition. By the middle of November, 1892 at least ten new cordage

[1] Property estimated by one local correspondent, May 10, 1893, at $25,000. Letter of Chas. E. Kinder, VI *Cordage Trade Journal*, 260.

mills in as many different localities, had been finished or were being built.[1]

In the winter of 1892 and spring of 1893, in the face of increasing competition, the National Cordage Company manufactured very large quantities of binder twine and something more than the normal production of rope.[2] In April, 1893, the Company was stocked with over fifty million pounds of binder twine and rope, representing an actual cost of between $5,000,000 and $6,000,000. Against this heavy item of quick assets, the Company had borrowed upwards of $5,000,000 from New York and New England banks. These loans were in the form of demand loans and short term commercial paper. At this juncture came the Reading receivership, and the acute stage in the free silver controversy. Some of the bankers notified the National Cordage Company that the merchandise loans would not be renewed to the same extent and the note-brokers recommended a contraction in the Company's borrowings.

During the last of April, 1893, business and financial conditions were far from satisfactory. Conditions abroad were unsteady and the failure of the National Bank of Australasia and the doubt concerning the outcome of our own currency legislation caused an uneasy feeling in the London market. Our rates of foreign exchange were very high and gold was steadily exported. Prompted by the rapid depletion in the Treasury's stock of gold, rumors were circulated in the newspapers that Secretary Carlisle contemplated the redemption of treasury notes in silver. These rumors produced such a bad effect that President Cleveland on the evening of April 23, authorized the emphatic denial of their truth. Yet the plight into which the Treasury had fallen through the steady exportation of gold and the equally steady purchase of silver called for immediate

[1] Auburn, N. Y.; Beverly, N. J.; Miamisburg, O.; Ludlow and Newburyport, Mass.; St. Paul, Minn.; and four new mills in Canada.

[2] The production of the subsidiary mills of the National Cordage Company, both rope and binder twine: —

Year ending October 31, 1890	43,411,725	pounds
1891	74,704,835	"
1892	130,315,156	"
Six months, ending April 30, 1893	80,757,197	"

and drastic action. Secretary Carlisle proposed that the New York banks should lend the Treasury $50,000,000 in gold. The expectation of some such action caused a severe contraction in mercantile credits during the last days of the month. Call money fluctuated violently between three and forty per cent.

At the close of the Stock Market on Friday, April 28, the National Cordage Company's stocks were strong with the preferred stock at $103.75 and the common stock at $61 a share.[1] In the presence of their rapidly maturing mercantile loans and commercial paper, and the unsettled condition of the money market, the Directors at a meeting held on Saturday, April 29, decided to issue $2,500,000 preferred stock to the stockholders at par. They gave as an excuse the seasonal character of the business, and the fact that the Company considered it unwise to depend on "temporary accommodation in the money market."[2] This move, which might have been conservative and wise if made months before, came at a time when the financial pulse was sensitive to the slightest irregularity. The fact that the Company had issued a stock dividend in January, and that its statements had indicated large earning power and a liberal surplus, served only to accentuate the doubt and uncertainty. Yet the Directors believed that they had gained the confidence of the public and that they could easily secure subscription to the preferred stock, the market price of which was above par. In this assumption they were mistaken, nor had they made adequate provisions to protect their stocks in case the news of the new issue should, as they might have expected, lead to short sales. When the old Keene pool was liquidated in the winter, a new pool had been formed in which certain of the Directors had the most substantial interests. This second pool had

[1] The new stock, after the declaration of the one hundred per cent stock dividend, referred to earlier. *Supra*, p. 132.

[2] Official statement in the Sunday papers of April 30, 1893. Mr. Waterbury stated that the preferred stock subscription was adopted on the advice of banking interests, consisting of J. H. Wright, of Drexel, Morgan & Co., Brayton Ives, of the Western National Bank and Geo. G. Williams of the Chemical National Bank. "These men thought that the issue could be made in safety. They advocated it warmly." Interview with J. M. Waterbury, *New York Herald*, May 5, 1893.

nothing like the financial strength of the Keene pool. So that when on Monday, May 1, the "bears" fell upon the securities of the National Cordage Company there were no strong banking interests to protect them.[1] The Directors did what they could,[2] but without much avail. The common stock fell to under $50 a share and the preferred to less than par. It was clear that, unless the preferred stock could be better supported, the new stock subscription would prove a failure. Accordingly the Directors issued another statement, published in the morning papers of Tuesday, May 2d, intended to reassure the stockholders. It was pointed out, on false grounds as it appeared later, that the Company had upwards of $4,000,000 in cash working capital and that the surplus of the current year, together with the proceeds of the new preferred stock issue, would bring the amount to $7,000,000.[3] During the day the pressure on the Cordage Company's stocks was distinctly less, but on Wednesday it was again renewed. The common stock fell precipitously from $50 to $36 and the preferred from $98 to $83. Clearly the new stock issue was a failure; nobody would subscribe at par for a stock possessing a market value of only $83. And in addition the rapid decline in the Company's securities had already done untold harm to its credit.

On Thursday, May 4, the seriousness of the Company's condition was thoroughly recognized. The officers were powerless to withstand the pressure which confronted them on all sides. The collapse had come suddenly and they were unprepared to meet it.[4] Before the end of the week upwards of

[1] The raid was probably helped by Keene himself. There were very substantial rumors to the effect that the operator had taken the short side of the market since the dissolution of the first pool. At all events he had ceased to coöperate with President Waterbury in supporting the Cordage Company's securities, owing possibly to the belief that one of the Directors had been false to his contract and had sold some of his own stock outside of the pool.

[2] J. M. Waterbury told the present writer that he supported the common stock down to fifty dollars a share.

[3] *The New York Journal of Finance*, May 2, 1893.

[4] The President and the Treasurer alone of the officers kept in close touch with the financial side of the Company's affairs; they were the only ones of the Directors who knew of the precarious condition into which the finances of the National Cord-

$561,000 in notes would mature[1] and subsequent examination of the accounts showed that the Company was carrying less than $100,000 in cash balances at the banks. Liquidation was renewed in the Company's stocks and neither the Directors nor the managers of their pool offered any support. The common stock opened at $37 and declined in a few minutes to $28. It finally reached $18.75. The preferred stock opened at $78 and declined to $65.[2] Three stock exchange firms collapsed during the day, all attributing their troubles to the inability of Mr. Waterbury to respond to calls for more margin on the National Cordage Company's stocks carried on account of the pool or for him individually.[3] One of these firms had been acting directly for the pool, and after its failure 2,200 shares of the National Cordage Company's stock was sold "under the rule."

age Company had fallen. The acute stages were of sudden development. For example, a Director went south on Saturday, April 29, believing everything sound. Telephoned for on Monday, during Wednesday and Thursday he raised $1,100,000 on his own notes in the hope of tiding over the crisis. In fact all the Directors had indorsed the Company's paper, which shows their faith in its ultimate success.

[1] Bill of Complaint for appointment of Receivers for National Cordage Company, presented to Chancellor McGill, May 4, 1893.

[2] The extreme fluctuations of the cordage stocks during the week may be seen from the following table (fractions omitted). Quotations of common are for the new stock, after the issue of the one hundred per cent dividend.

	April 29	May 1	May 2	May 3	May 4	May 5
Common	59–57	57–49	52–49	49–35	37–18	22–15
Preferred	102–101	101–99	100–89	98–83	78–65	57–45
Sales in shares						
Common	8,460	39,950	13,900	23,690	101,200	32,250
Preferred	25	1,800	1,000	2,800	4,600	2,000

[3] Henry Allen and Company, — the firm who took care of the "pool's" account said: "In the bad breaks in market values yesterday the margins of some important customers were exhausted, but as these customers were not only reputed to be solvent, but very rich men, the firm took care of their accounts, out of its own resources, on pledges from these customers that about $200,000 in cash would be paid back before a quarter past ten o'clock this morning. These promises were not kept." A member of the firm later said "among the customers who had failed to keep their promises was James M. Waterbury, President of the National Cordage Company." (*New York World*, May 5, 1893.)

Schuyler Walden, the second firm that failed, said (*New York Sun*), "'I had n't the faintest idea that trouble was at hand. Mr. Waterbury had been very kind to me. This has come like a thunderclap. The banks began calling for additional margin on Cordage, and I naturally looked to Mr. Waterbury. I learned this morning that he would n't respond, and I had to go under.'"

These events on the Stock Exchange made the condition of the Company even more precarious and late in the afternoon the Directors of the Company voted to authorize President Waterbury to prepare a Bill of Complaint praying for the appointment of Receivers. At half past ten in the evening Mr. Waterbury appeared at the house of Chancellor McGill at Jersey City and confessed default to a demand note of $50,000 presented by the National Park Bank. Receivers were appointed late in the night.[1] "Cordage has collapsed like a bursted meteor."[2]

[1] Edward F. C. Young, President of the First National Bank of Jersey City, and G. Weaver Loper, appointed Receivers. The latter was Treasurer of the National Cordage Company.

[2] Editorial in *Commercial and Financial Chronicle*, May 6, 1893, 56 *Chron.* 728.

CHAPTER VI

The Reorganizations of the Cordage Consolidations

Effect of the failure of the National Cordage Co., 140; first reorganization plan, 142; modified plan, 145; organization of United States Cordage Company, 147; failure of United States Cordage Company, 152; plans of reorganization, 152; the Standard Rope and Twine Company, 154; the reorganization of the Standard Rope and Twine Company, — The Standard Cordage Company, 160; fundamental cause of disaster of the Cordage Consolidation, 162.

Chronological Summary

1893. Reorganization of the National Cordage Company.
1894. United States Cordage Company begins business.
1895. Failure of United States Cordage Company.
1896. Business assumed by Standard Rope and Twine Company.
1905. Failure and reorganization of Standard Rope and Twine Company.
1912. Liquidation of Standard Cordage Company.

The failure of the "cordage trust" dealt a severe blow to business confidence. Coming as the failure did, directly after the Reading receivership, when the banking community was greatly disturbed over the heavy floating debt of the Northern Pacific Railroad, and worst of all, when the whole country was in the throes of the free silver controversy, the cordage "scandal" was thrown into clear relief as a glaring example of unsound "trust" finance. Charles R. Flint testified that it "discredited almost every industrial then existing."[1] The Company had declared a hundred per cent stock dividend late in January, and gone into the hands of receivers early in May. No financial methods quite like these had been known before, except perhaps the payment of the dividend on the preferred income bonds of the Philadelphia and Reading Railroad, on the eve of the receivership. But in the case of the Cordage Company the

[1] XIII *R. I. C.* 91.

financial world was dealing with a totally unknown quantity, for the promotion of industrial combinations had but just begun. Every industrial security was tainted by the cordage collapse. Nothing seemed sound, nothing secure. General Electric stock fell from $84 to $58 a share during the day following the failure;[1] even conservative railway issues, such as that of the Central of New Jersey, fluctuated from three to five points.

The failure of the Cordage Company was all the more noteworthy, because it was the first disaster to befall a large industrial consolidation. During the later eighties and the early nineties occurred the first small wave of industrial promotions. Although small when compared with the fever of promotion a decade later, it had attracted wide attention throughout the country. The Sherman Act of 1890 was the climax of this movement, and the Cordage failure the dramatic end. The press throughout the country cited the National Cordage Company as an example of wild promotions, and the iniquitous ways of Wall Street. Even financial circles were stunned. They had had confidence in the Directors of the National Cordage Company, because the men were manufacturers thoroughly familiar with their business. They were, perhaps, the ablest men in the industry. Sound economic principles lay at the basis of the administration of the plants and in the first years of its history, the four mills that went into the original trust were successful. When, however, two executives of the Company became more interested in the market quotation of their stocks than in the wise administration of their cordage mills, the enterprise was changed from a business to a speculation. Extension of control became a mania with the officers, and their ambition stifled their sound business judgment. They dreamed of an absolute monopoly of which they should be masters, and in the fever of conquest they lost the shrewdness of judgment which had enabled them to acquire their first success. As the

[1] So serious, indeed, did the condition appear that President C. A. Coffin of the General Electric Company issued an elaborate statement. (56 *Chron.* 792.)

panic of 1893 approached, they were unprepared to meet it. The well organized business of two years before had changed, through the craze for extension, into an unwieldy and loose composite. The withdrawal of the bankers' credit was merely the occasion, not the cause, of the collapse.

Recognizing the necessity of a quick reorganization of the National Cordage Company's finances a Reorganization Committee[1] was arranged by the banking interests. A report was published under the date of June 15, 1893.[2] In this report the members of the Reorganization Committee showed a lack of appreciation of the magnitude of the failure. "Their examination into the affairs of the Company led them to believe that the chief impediment to the financial success of this Company has been that of lack of adequate working capital."[3] In other words the Committee in their first opinion attributed the failure of the Cordage Company to the exigencies of tightened credit. And in this presumption they were borne out by the report of the Accountants who found current assets equal to $10,500,000 and the real estate account approximately $15,000,000 more, making the total assets well over $25,000,000.[4] The debt was close to $12,000,000. It appeared, therefore, as if the Reorganization Committee would have no difficulty in placing the finances of the Company on a secure footing, by merely liquidating the current assets and funding some of the liabilities.[5] The plan proposed was concerned entirely with a

[1] George C. Magoun of Baring, Magoun and Company, Ernst Thalmann of Ladenburg, Thalmann and Company, Gustav H. Gossler of G. Ainsinck and Company. It was commonly believed that Thalmann did the real work of the reorganization.

[2] Report actually circulated some time before; summary in 56 *Chron.* 973, June 10, 1893.

[3] Reorganization Committee Report, June 15, 1893, p. 1.

[4] The accountants, Deloitte, Dever, Griffiths and Company, reported, "We find the value of the Real Estate, Plant, Good Will, etc., as recorded on the Books of Account, to be $14,931,361." (Letter of Deloitte, Dever, Griffiths and Company to Reorganization Committee, 10th June, 1893.) On September 30, 1893, another accountant for the Receivers, Mr. Seaward, valued these same assets at $2,934,388. (Report of November 20, 1893.)

[5] The following is a brief summary of the balance sheet as certified to by De-

readjustment of the debt of the Company in such a way as to relieve the tension.[1] The proposition first advanced was simple.[2] The Company was to create collateral trust, first mortgage six per cent bonds to the amount of $6,000,000 for which the stockholders were asked to subscribe at eighty-five per cent.[3] A cash assessment of $20 per share was levied on the preferred stock, and $10 a share on the common stock.[4] In return for

loitte, Dever, Griffiths and Company on the basis of the National Cordage Company's books. (May 4, 1893): —

ASSETS

	Pledged as Collateral	Free	Total
Cash		$72,966	$72,966
Customers' and agencies' open accounts	$143,000	679,200	822,200
Sub-company notes	497,475	382,087	879,562
Customers' notes	16,500	126,776	143,276
Miscellaneous contingent items		65,102	65,102
Balance due from note-brokers		138,596	138,596
Inventories, — hemp, sisal, rope, and binder twine	4,896,935	2,292,472	7,189,407
Hemp at agencies and in transit		331,139	331,139
Bonds of controlled companies (mostly Security Corporation)	344,000	82,025	426,025
Assets of individual mills, in excess of their individual liabilities		395,384	395,384
Total quick assets	$5,897,910	$4,565,747	$10,463,657
Book value of plant, good-will, etc. ($337,500 of this, payments account of Security Corporation)			15,268,861
Total nominal assets			$25,732,518

LIABILITIES

Acceptances	$1,209,724
Collateral loans	5,596,706
National Cordage Company's single name paper	597,010
Open accounts and contracts	957,604
Notes and contingent liabilities of subsidiary mills	3,625,374
Total quick liabilities	$11,986,418
Excess of assets over liabilities	$13,746,100

In addition one should remember that there was a contingent liability of $6,000,000 on account of guarantee of Security Corporation's bonds. And it afterward developed that there were underlying purchase money mortgages on some of the mills amounting to $1,385,000.

[1] The Reorganization Committee desired to achieve the following four purposes:

1. To fund a part of floating debt.
2. To induce stockholders to provide new working capital.
3. Creation of new preferred stock.
4. Acquisition of additional properties.

[2] Contained in first circular of the Reorganization Committee, June 15, 1893.

[3] Underwritten at 80. (56 *Chron.* 1015.) When the stockholders refused to subscribe, the underwriters were relieved of their responsibility. This seems to have been due to the exigencies of the panic of 1893.

[4] Those of the common stockholders who declined to pay the assessment might surrender fifty per cent of their holdings. (Reorganization Plan, June 15, 1893, article 2.)

these assessments, it was proposed to issue new preferred stock.[1] Had the full amount of cash been contributed by the stockholders, the corporation would have been supplied with $7,000,000 of new capital. This, with the money realized from the sale of the quick assets, would have put the finances of the Company, it was thought, in good form.

Certain unforeseen circumstances, however, prevented the consummation of this plan. Most general, and perhaps most serious of these, was the continued depression of 1893. The banking community became thoroughly aroused over the monetary and financial situation; and the Receivers of the National Cordage Company were pressed for the immediate payment of the outstanding notes. Unfortunately for some of the creditors, certain of the notes were secured by direct liens on specific quantities of cordage, which the bankers forced on the market; and, in consequence, the price of both hemp and cordage fell rapidly.[2] Orders were cancelled on account of the cumulative effect of the panic of 1893; creditors failed, so that what were considered perfectly good assets at the beginning of the year yielded but a small percentage of their face value.[3] On top of all these circumstances, certain revelations regarding the auditing methods of the Company tended to aggravate the feeling of uncertainty. The first statement, made soon after the appointment of Receivers, showed only the direct liabilities of the National Cordage Company. In due course of time, notes were presented for payment, uttered by the subsidiary companies, or by the Directors themselves[4] which the National

[1] To effect this, the preferred issue was to be increased from $5,000,000 to $8,000,000.

[2] Much was made by contemporary competitors of what they called the "bankers' twine," and the disturbance it created in the cordage market. The price, however, did fall to a low figure. Sisal hemp (largely used in binder twine) fell from 6⅝ cents in January, 1893, to 3½ cents in August, 1893. Of course the price of the twine itself fell correspondingly. J. M. Waterbury testified before the Industrial Commission, "binder twine which was worth, and would have sold, for about $6,000,000, sold for about $2,500,000." (XIII *R. I. C.* 134.)

[3] Accounts worth $1,851,076 were estimated by the Reorganization Committee, November 20, 1893, to be worth only $600,000.

[4] Intense feeling, and the most severe criticism were directed against the President and the Treasurer, to whose lax methods and speculative propensities the

Cordage Company had endorsed, but which were not entered on its books. The makers allowed these notes to go to protest, and the liability fell back on the parent Company.[1] These unrecorded liabilities, and other claims not known to the receivers, amounted to over $1,500,000. To make conditions worse, the Directors having charge of the loan transactions had apparently deceived the bankers. The management had assured the bankers that immense quantities of binder twine had actually been sold and that the loans were against "bills receivable," not against inventoried merchandise the value of which was subject to a fluctuating market. Soon after the failure it developed that many of these so-called sales were merely consignments to the consumer and to the western intermediary. The very large profits, supposed to have been made on binder twine, were supposititious profits and should never have been treated as actually earned. The sale of these consignments after the failure resulted in heavy losses. Furthermore, Mr Seaward, accountant for the Receivers, changed the fixed assets of the Company from $14,931,360 to $2,934,388 [2] on the basis of a forced and immediate sale.[3]

As these unlooked for revelations came to light one after another, uncertainty regarding the true standing of the Company increased. Recognizing that a drastic readjustment would be necessary, the Reorganization Committee published a second circular, in November, 1893. This provided that the secured debt should be paid through the sale of the pledged assets.[4]

collapse was attributed. It should be said, however, that the Directors themselves had had faith in the Company to the very end, and lost practically everything in the collapse. The strain upon them was terrible.

[1] "A large number of debts, upon which the Company was only contingently liable as endorser, and which, therefore, did not appear in the accounts as liabilities, and which were not expected to become liabilities, have become actual liabilities by the failure and default of the principal debtors." Reorganization Committee Circular to Creditors, November 20, 1893. Published in full, 57 *Chron.* 900.

[2] Reorganization Committee Circular to Creditors, November 20, 1893.

[3] "Upon the theory that the mills must be sold separately, at forced sale, upon a given date, without regard to the future use to be made of them." Reorganization Committee Circular to Stockholders, November 20, 1893.

[4] The secured debt amounted to $3,495,978, for which was pledged merchandise appraised, September 30, 1893, at $4,100,489.

It also proposed that the claims of the unsecured creditors[1] should be met by the payment of twenty-five per cent in cash, ten per cent in Trust Liquidation Certificates to be redeemed through the liquidation of the open accounts, and sixty-five per cent in new bonds taken at their par value. The plan was recommended to the creditors through a "Bankers' Committee,"[2] and by the end of the year nearly all of them had assented.[3]

The new plan, reduced to its simplest terms, provided (*a*) For the formation of a new Company, to be called the United States Cordage Company, which should take over the assets of the National Company by a purchase of its property; (*b*) For the issue of $7,500,000, six per cent first mortgage bonds by the new Company, which should be used to pay sixty-five per cent of the unsecured debt,[4] and to refund $1,657,000 of underlying liens on the various mill properties. These bonds were secured by a mortgage on the mills and the intangible assets of the Company; (*c*) For the issue of $6,000,000 "guaranteed" first preferred stock, to be exchanged, at par, for the old Security Corporation's six per cent mortgage bonds.[5] Through the cancellation of these bonds, the Security Corporation was in a position to deed its eight mills to the new Company subject only to underlying mortgages of something less than $1,500,000; (*d*) For the issue of new second preferred stock, amounting to $8,000,000. Of this amount, $5,000,000 represented the preferred stock in the old Company, and $3,000,000 represented the cash assessments paid on the old stocks; (*e*) For the issue of about $875,581

[1] The unsecured debt amounted to $8,755,814, September 30, 1893. Later about $500,000 had to be added.

[2] George G. Williams, President, Chemical National Bank; George S. Coe, President, American Exchange National Bank; W. W. Sherman, President, National Bank of Commerce.

[3] December 23, 1893; $11,300,000 out of $12,750,000.

[4] Unsecured debt, September 30, 1893, $8,755,814; December 30, 1893, $9,300,000 (approximately). 57 *Chron.* 1083. Add, also, interest to date of settlement. The amount actually issued in the first instance was $6,076,000 which is sixty-five per cent of $9,348,000. (Listing Application, New York Stock Exchange, May 1, 1894.)

[5] Most of these Security Corporation bonds were held by the cordage men and the agreement of virtually all the bondholders was obtained before the announcement of the plan.

of temporary "Trust Liquidation Certificates" which should be redeemed, as rapidly as possible, by the liquidation of the open accounts.

The new capitalization can be seen at a glance from the table which appears on the following page.

The tabular diagram shows that, as far as the issued capitalization is concerned, the new Company was more heavily burdened than the old, — $41,500,000 for the new over against $32,657,000 for the old. It would seem, too, that the total charges had been increased from $850,000 to $1,450,000. Yet, if we take into consideration the outstanding debt, not funded, as we certainly must do in comparing the liabilities of the two companies, just the opposite result appears. The floating and permanent obligations were actually reduced, — $39,375,000 for the new, over against $45,157,000 for the old Company. In a word, the reorganization turned upon the funding of the floating debt. As a result, the financial position of the Company became simpler and stronger. Its weak points lay in the large increase in cumulative charges on the two classes of preferred stocks and in the important fact that the reduction in capitalization and charges was not more drastic.

By the middle of December, 1893, ninety per cent of the floating debt had assented to the plan of readjustment. During the time, ninety-nine per cent of the preferred stock and ninety-six per cent of the common stock had been deposited under the Reorganization Agreement. The plan was, therefore, declared operative. The assets of the National Cordage Company were bid in at the Receivers' sale, by an attorney for the United States Cordage Company, for the sum of $5,000,000.[1] On December 26, 1893, the United States Cordage Company was incorporated, and the new organization had actually assumed the management of the business by the beginning of the new year. The officers of the Company were selected from among the members of the Reorganization Committee, the advisory bankers, and the management of the Sewall and Day Mill, one of the later and most successful of the National Company's acquisitions. The

[1] 57 *Chron.* 1083.

	NATIONAL CORDAGE COMPANY					UNITED STATES CORDAGE COMPANY					
	Underlying Bonds	Interest Charges	Preferred Stock	Contingent Charges	Common Stock	Bonds	Interest Charges	Guaranteed Stock	Preferred Stock	Contingent Charges	Common Stock
Security Corporation Debentures	$6,000,000	$360,000	....	....	....	....	....	$6,000,000	....	$360,000	....
Underlying Mortgages	1,657,000	90,000	....	....	....	$7,500,000	$450,000	...	....	....	....
Preferred Stock	....	....	$5,000,000	$400,000	....	....	....	....	$8,000,000	640,000	....
Common Stock	....	....	....	....	$20,000,000	....	....	....	....	....	$20,000,000
Totals	$7,657,000	$450,000	$5,000,000	$400,000	$20,000,000	$7,500,000	$450,000	$6,000,000	$8,000,000	$1,000,000	$20,000,000
Floating Debt	$12,500,000	$725,000				$875,000	$52,500				

SUMMARY	Old	New	Change: Amount	Change: Percentage new to old
Securities bearing Interest	$7,657,000	$7,500,000	− $157,000	98%
Liabilities bearing Interest	20,157,000	5,375,000[1]	−14,782,000	26%
Securities bearing Fixed and Contingent Charges	12,657,000	21,500,000	+ 8,843,000	170%
Total Securities	32,657,000	41,500,000	+ 8,843,000	127%
Total Liabilities	45,157,000	39,375,000[1]	− 5,782,000	87%
Fixed Charges	450,000	450,000	....	100%
Current and Fixed Interest Charges	1,175,000	352,000[1]	− 823,000	30%
Fixed, Current and Contingent Charges	1,575,000	1,352,000[1]	− 223,000	86%
Fixed and Contingent Charges	850,000	1,450,000	+ 600,000	170%

[1] Allowing deduction of $3,000,000 contributed by stockholders.

old officers of the National Cordage Company ceased to have any connection with the new concern. The reorganization involved, therefore, not only a readjustment of the finances of the Company, but also an abrupt change of management and policy.

The United States Cordage Company acquired twenty-two mills.[1] During the first months of the Company's business, the market for cordage was very much depressed, on account of the quantity of twine deposited for collateral against the loans to the old National Company. The bankers who held this twine were anxious to realize upon it at the earliest moment. Subsequently, the tension was relieved through the formation of the Western Twine Company,[2] which assumed charge of this "Bankers' Twine."[3] Late in the year it was announced that the banking connections of the Company had been strengthened. It seemed on the whole, therefore, that the United States Cordage

[1] The following list of mills is entered merely to make the record complete: —

Waterbury Mills, Brooklyn, N.Y.
Wm. Wall's Sons, Brooklyn, N.Y.
Tucker and Carter, Brooklyn, N.Y.
Victoria Cordage Co., Dayton, Ky.
Xenia Twine and Cordage Co., Xenia, Ohio.
J. Rinek's Sons, Easton, Pa.
Miamisburg Cordage Co., Miamisburg, Ohio.
Miamisburg Binder Twine and Cordage Co., Miamisburg, Ohio.
Elizabethport Cordage Co., Elizabethport, N.J.
Hanover Cordage Co., Hanover, Pa.
Donnell Cordage Co., Bath, Maine.
Chelsea (formerly Suffolk), Chelsea, Mass.
Sewall and Day Cordage Co., Allston, Mass.
Boston Cordage Co., Boston, Mass.
Laurence Rope Works, Brooklyn, N.Y.
Standard Cordage Co., Boston, Mass.
Middletown Twine Co., Middletown, Ohio.
American Cordage Co. (Field Cordage Co.), Xenia, Ohio.
New Bedford Cordage Co., New Bedford, Mass.
Ohio Twine and Cordage Co., Xenia, Ohio.
Chicago Cordage Co. (Wm. Deering and Co.), Chicago, Ill.
Galveston Rope and Twine Co., Galveston, Texas.

Application for listing, New York Stock Exchange, May 1, 1894, copy in 58 *Chron.* 820.

[2] 59 *Chron.* 740.

[3] XIII *R. I. C.* 134, 147, 149.

Company would be able to weather the depression following the crisis of 1893, in spite of the inheritance of debt from the old management.

The real condition of the business, however, had not been improved. The severe losses which the old National Company had sustained in its over-purchases of hemp were, to a large extent, passed on to its successor. Nor was there a change for the better in the skill of management shown by the officers of the new organization. During 1894, the Company purchased 85,000,000 pounds of hemp in a rapidly declining market. Its consumption was only 46,800,000 pounds.[1] The Company carried over to 1895, — allowing for stocks received from its predecessor, January 1, 1894, — 28,000,000 pounds of hemp and 24,600,000 pounds of rope and twine, all representing a cost price higher than the current market. In fact, the sales for the year 1894 amounted to less than $2,500,000,[2] and the purchases of raw material to over $3,500,000.[3] In order to finance these ill-advised operations, the Company became a heavy borrower, using as collateral for this all its available current assets. To make matters worse, the Company tied up more capital in plants. It bought the Pearson binder twine mill, in Boston, from the McCormick Harvesting Machinery Company, for $900,000,[4] of which $500,000 was paid in cash. This was done in the face of the heavy supplies of binder's twine which the bankers held over the market, and the clearly recognized fact that the United States Cordage Company was not then operating at its full capacity.[5] At the time it was tying

[1] Investigations by a Bondholders' Protective Committee of which Robert L. Niles was Chairman. Summary will be found in 60 *Chron.* 1106, June 22, 1895.

[2] $2,496,389, Bondholders' Protective Committee Circular (60 *Chron.* 1106). The Annual Report had shown sales amounting to $3,239,703. (1894, U. S. C. Co. Rep.) Summary, 60 *Chron.* 80.

[3] $3,683,120, Bondholders' Protective Committee Circular, 60 *Chron.* 1106. Annual report gave purchases of raw material as $3,453,173. (1894, U. S. C. Co. Rep.)

[4] 1894, U. S. C. Co. Rep.

[5] The plant was really bought from the McCormick interests to exclude them from the binder twine market. Three years before J. M. Waterbury had testified that the Pearson mill was the largest eastern competitor of the National Company

up $500,000 working capital in the purchase of the Pearson mill, it found itself compelled to borrow $500,000 to meet the January, 1895, interest on its funded obligations.[1] Nor did the reorganized Company maintain its position in the industry.[2] In the face of the depressed conditions of trade, new competition arose. The officers of the National Company, displaced by the new management of the Reorganization Committee, started to manufacture cordage under the old firm names.[3] The Plymouth and the Fitler Companies, never having been in the consolidation, acquired new vigor after the failure of the National Company. More threatening yet were the conditions in the binder twine trade. The two leading manufacturers of harvesting machinery were the Deering and McCormick Companies. The former had purchased millions of pounds of twine of the old National Company, but after the failure had found it very difficult to secure the fulfilment of its contracts.[4] On account of this difficulty and from a desire to be quite independent, Wm. Deering & Company commenced to manufacture its own binder twine. By refusing to guarantee its binders when used with other twine, the Deering Company was able to secure an advantage with the farmers over the independent mills. The McCormick interests followed a similar policy so that the United States Cordage Company found its twine market growing narrower and narrower.

in the binder twine business. (Balch *v.* National Cordage Company.) The purchase did not achieve its end, as the McCormick interests established soon afterward a new and thoroughly modern binder twine mill in Chicago.

[1] 59 *Chron.* 740.

[2] Some of the officers of the new Company seemed to be affected by the same desire to obtain a monopoly of the Cordage business. For example, at one stage it was hoped to effect a combination with the Fitler, Tubbs, Plymouth and Pearson Companies, the four largest producers outside of the United States Cordage Company (see 57 *Chron.* 257).

[3] For example, the Waterbury Company under J. M. Waterbury; William Wall's Sons Company under Frank T. Wall; and the Tucker and Carter Cordage Company under a son of John M. Tucker. The Elizabethport became the Whitlock Cordage Company. The Waterbury Company actually offered its stock for public subscription in 1903. 76 *Chron.* 387, 439.

[4] Several suits were commenced, notably U. S. Circuit Court (Chicago), May 12, 1893. Later discontinued.

Beset by all these difficulties, the United States Cordage Company failed on June 3, 1895, in less than a year and a half after its organization. With the announcement of the Receivership [1] came the announcement of a plan of reorganization involving the creation of a new first mortgage which should be put ahead of the first mortgage bonds of the United States Cordage Company.[2] As soon as the financial distress of the Company was known, a Protective Committee [3] of the bondholders arose. The bonds of the Company had been acquired by bankers, in part payment of the unsecured debt of the old National Cordage Company. As bankers, they were very reluctant to allow a Reorganization Committee to place other bonds ahead of theirs, especially before they had had an opportunity to investigate the conduct of the business. Almost coincident with the bankers' "Bondholders' Protective Committee," another "Committee of Enquiry" [4] sprang into existence, backed largely by the preferred stockholders. Robert L. Niles, as Chairman of this Committee, solicited subscriptions [5] from all the security holders, in order to enable the Committee to prosecute a vigorous investigation into all the affairs of the Company. The members of the "Bondholders' Protective Committee" reported a week after they had begun the investigation, that "your committee feel justified in advising you that they are unable to discover

[1] The Receivers were John I. Waterbury, President of Manhattan Trust Company, and William E. Strong, a partner of Frank K. Sturgis, who, by request of the bankers, — who were under heavy advances to the Company, — had become President of the United States Cordage Company. The Receivers were, of course, friendly to the management, and they were appointed in the hopes of effecting a friendly reorganization.

[2] Announcement and brief summary of plan in 60 *Chron.* 1012, June 8, 1895.

[3] Dumont Clarke, American Exchange National Bank; R. M. Galloway, Merchants' National Bank; Ebenezer S. Mason, Bank of New York; Stuyvesant Fish, National Park Bank; Charles A. Vialle, National Bank of the Republic, Boston; George Ripley, Hide and Leather National Bank, Boston. Summary Statement, 60 *Chron.* 1060, June 15, 1895.

[4] Robert L. Niles, Niles Brothers; Charles E. Orvis, Orvis Brothers and Company; Josiah C. Reiff, Woerishoffer and Company; A. R. Pick, A. R. Pick and Company.

[5] Fifty cents per $1,000 bond; four cents per share first preferred; two cents per share second preferred; and one cent per share for the common stocks.

any sufficient ground to justify the proposal that you should exchange your first mortgage bonds for second mortgage income bonds. . . ."[1] Following this announcement, came a new plan of reorganization which differed in certain important respects from that of the Receivers. Both plans, however, were based on a belief that the United States Cordage Company was overburdened with capitalization, and both looked toward the simplification of the finances of the Company, through the extinction of the various classes of preferred stock. Both plans involved an assessment on the stockholders, and both proposed to create a new first mortgage. The two plans differed chiefly in the fact that the Bondholders' Committee proposed to create only two classes of securities, — first mortgage bonds and common stock; whereas the Receivers proposed to interpose between the two classes a new issue of income bonds.

The Bondholders' Protective Committee's Plan proposed to give each bondholder of the old Company, without assessment, $600 in new bonds, and $400 in new stock. All the stocks were to contribute cash, but new bonds were to be issued for the amount of the payment. The first preferred was to be assessed $15 a share, and would receive $90 in new common stock; the second preferred $7.50, and receive $45 in new common; and the old common stock was to pay an assessment of $3.75, and receive $22.50 in new stock. In all the plan called for $6,250,000 new first mortgage bonds, and $16,250,000 new stock, all of one class. The bonds were to bear five per cent interest for three years, and six per cent thereafter for the rest of their life.[2] The Receivers' plan required the exchange of the old First Mortgage Bonds into new Income Bonds, and the creation of 3,000,000 of new First Mortgage Bonds to be given entirely for the assessments on the stocks. The first preferred stock was assessed $20, and received $80 in new common stock; the second preferred, $10, and received $40 in new stock; and the old common stock was assessed $5 a share, and received

[1] Report Bondholders' Protective Committee. Summary, 60 *Chron.* 1106, June 22, 1895.

[2] Bondholders' Protective Committee Plan and Agreement, Circulars. Brief summary in 61 *Chron.* 113.

\$20 in new stock, — all in addition to the mortgage bonds representing the assessments.[1] The details of the two plans are most clearly understood from the table which appears on the next page.

A comparison of the plans shows that on the whole the old bondholders were somewhat less favored in the Receivers' plan than in their own; yet it was obvious that everyone informed recognized that a drastic reduction in the outstanding securities was absolutely necessary.

In the course of the next few weeks, it developed that the Receivers' plan was more acceptable to the great body of security holders.[2] The majority of bondholders preferred it because they obtained all bonds, rather than part stock, and the first mortgage bonds ahead of them were so few that they believed interest on the new income bonds not imperiled. The stockholders preferred it because the necessary fixed charges, not including the income bond interest, were so small that they thought there was little probability of another reorganization. Also, the only first lien bonds were represented by their own assessments, instead of partly by the refunded bonds of the old United States Cordage Company, as was contemplated in the Bondholders' Protective Committee plan. Whatever the various motives may have been, it became clear, by the end of August, that the Receivers' plan was securing the deposit of most of the securities. The Bondholders' Protective Committee, therefore, withdrew its plan.[3] From this time on, all interests worked in harmony for the consummation of the Receivers' plan. A comparison of the capitalization of the old United States Cordage Company and the new Standard Rope and Twine Company will show the drastic cutting down of capitalization which the execution of this plan involved. All securities were cut at least in half. (See table, page 156.)

On November 8, 1895, the Standard Rope and Twine Company was incorporated under the laws of New Jersey, and in due

[1] Reorganization Committee Circular, June 5, 1895. Brief summary in 60 *Chron.* 1012.

[2] 61 *Chron.* 70, 153, 198, 241.

[3] 61 *Chron.* 328.

	BONDHOLDERS' PROTECTIVE COMMITTEE PLAN						RECEIVERS' PLAN						
	Old Securities United States Cordage Co.	Cash Assessment	Securities to be given for U S. Cordage Co. securities on payment of assessment				Cash Assessment	Securities to be given for U. S. Cordage Co. securities on payment of assessment					
			Bonds		Stock (one class)			First Mortgage Bonds		Income Bonds		Stock (one class)	
			Single	Aggregate	Single	Aggregate		Single	Aggregate	Single	Aggregate	Single	Aggregate
Bonds	$7,500,000[1]	None	60%	$4,000,000	40%	$2,750,000	None	....	. ..	100%	$6,750,000 (approx.)	. ..	....
First Preferred..	6,000,000	15.	15.	900,000	90	5,400,000	$20	$20	$1,200,000	..	. .	80%	$4,800,000
Second Preferred	8,000,000	7.50	7.50	600,000	45	3,600,000	10	10	800,000	....	....	40%	3,200,000
Common	20,000,000	3.75	3 75	750,000	22 50	4,500,000	5	5	1,000,000	...	....	20%	4,000,000
Totals	....	.. .	....	$6,250,000	..	$16,250,000		..	$3,000,000	....	$6,750,000	...	$12,000,000
Total Capitalization						$22,500,000[2]							$21,750,000[2]
Total Assessment						2,250,000							3,000,000
Net Capitalization						20,250,000							18,750,000
Fixed Charges				$312,500					$180,000				
Contingent Charges									337,500				
Charges before Stock				312,500					517,500				

[1] $6,543,500 issued.

[2] Not allowing for about $2,105,500 underlying liens.

	UNITED STATES CORDAGE COMPANY					STANDARD ROPE AND TWINE COMPANY Formed in accordance with Receivers Plan[1]					
	Bonds	Interest Charges	Preferred Stock	Contingent Charges	Common Stock	Cash Assessments	Mortgage Bonds	Interest Charges	Income Bonds	Contingent Charges	Common Stock
Underlying Bonds	$1,205,500	$70,000	....	....	....	....	$1,205,500	$70,000	....	....	....
Mortgage Bonds	6,750,000	400,000	....	....	....	....	....	....	$6,750,000	$337,500	....
Banker's Collateral Trust Notes	900,000	50,000	....	....	....	....	....	....	....	....	....
Guaranteed Stock	....	....	$6,000,000	$360,000	....	$1,200,000	1,200,000		....	....	$4,800,000
Preferred Stock	...	....	8,000,000	640,000	....	800,000	800,000	180,000	....	....	3,200,000
Common Stock	....	....	....	....	$20,000,000	1,000,000	1,000,000		....	....	4,000,000
Totals	$8,855,500	$520,000	$14,000,000	$1,000,000	$20,000,000	$3,000,000	$4,205,500	$250,000	$6,750,000	$337,500	$12,000,000

SUMMARY

	Old	New	Change Amount	Change Percentage new to old
Securities bearing Interest	$8,855,500	$4,205,500	−$4,650,000	47%
Securities bearing Fixed and Contingent Charges	22,855,500	10,955,500	−11,900,000	48%
Total Securities	42,855,500	22,955,500	−19,900,000	51%
Fixed Charges	520,000	250,000	− 270,000	48%
Fixed and Contingent Charges	1,520,000	587,500	− 932,500	38%

[1] For details of distribution see preceding table.

course of time took over the best mills of the United States Cordage Company. The reorganization had cut the total capitalization in halves, reduced the necessary fixed charges from over $500,000 to less than $200,000 and furnished the Company with $3,000,000 of new capital. The prospects of success for the Company were the brightest since the failure of the National Cordage Company nearly three years before.

It is not of great profit to follow in detail the uneventful, and on the whole, unfortunate, history of the Standard Rope and Twine Company. The Company took over from the United States Cordage Company only five mills.[1] Of these five, the Company operated only three, — the Sewall and Day mill, just outside of Boston, and the Waterbury and Laurence mills, in Brooklyn, New York. During the first year, the Company suffered from the keen competition of the newer mills, "and the pressure to distribute goods manufactured has been greater than ever before in the trade."[2] The Company sustained a

[1] The following facts are stated merely for record. The Receivers of the United States Cordage Company took over, after the failure of the Company, twenty-one mills: —

1. Sewall and Day, Boston.
2. Pearson, Boston.
3. Waterbury, Brooklyn.
4. Laurence, Brooklyn.
5. Elizabethport, Elizabethport, N.J.
6. Boston, Boston.
7. Standard, Boston.
8. Chelsea, Boston.
9. Wm. Wall's Sons, Brooklyn.
10. Tucker and Carter, Brooklyn.
11. Victoria, Dayton, Ky.
12. Hanover, Hanover, Pa.
13. Middletown, Middletown, O.
14. Ohio, Xenia, O.
15. Miamisburg, Miamisburg, O.
16. Miamisburg (2), Miamisburg, O.
17. Xenia, Xenia, O.
18. American, Xenia, O.
19. Rinek, Easton, Pa.
20. Donnell, Bath, Me.
21. New Bedford, New Bedford.

Of these 21 mills, the Receivers of the United States Cordage Company deeded to the Standard Rope and Twine Company the first five. Subsequently, the Standard-Boston Mills were acquired. The Chelsea, Wall, Tucker and Carter, and Victoria Mills, — numbers 8 to 11 inclusive in the above, — were deeded by the Receivers of the United States Cordage Company to the Cannabis Manufacturing Company, all of whose $200,000 capital stock was held in the treasury of the Standard Rope and Twine Company. The remaining ten mills, — numbers 12 to 21 inclusive, — were sold by the Receivers of the United States Cordage Company, and the proceeds used for paying the expenses of the reorganization; and the balance turned over to the Standard Rope and Twine Company's treasury. Report of Thompson Committee. 1901, S. R. T. Co. Rep. 10.

[2] 1897, S. R. T. Co. Rep. 3.

deficit of over $400,000. During the succeeding years of the Company's history the business ran constantly behind, the deficit creeping up with each successive report.[1]

Moreover, the Company had not the loyal service of its chief officers. This is illustrated by two significant incidents. The first President, V. P. Travers,[2] proposed, in 1896, that the Company should take over certain processes controlled by him for forcing oil into rope. With this in view, a contract was entered into which permitted Mr. Travers to spend $25,000 of the Company's money in perfecting his inventions. As was shown later, "he made engagements involving the Company in expenditure of a much larger amount."[3] The processes proved worthless, and the Company lost heavily, both through the cost of useless machinery, and the waste of the goods manufactured. The President refused to bear the expense of the experiment, as his contract stipulated, and he resigned his position. Later he sued the Company, and the Directors compromised for $10,000. The whole affair cost the Company $126,402.93.[4]

[1]

1897	$403,931 deficit.	1901	$630,994 deficit.
1898	233,563 profit.	1902	98,088 deficit.
1899	75,551 profit.	1903	151,628 deficit.
1900	2,042 profit.	1904	9,167 deficit.

This unfortunate exhibit was not due to the conditions in the industry. During the last two years, for example, the Plymouth Cordage Company had been able to pay eight per cent dividends on $1,500,000 of capital stock, and to increase its surplus and reserve each year by upwards of $100,000.

[2] The bankers were in control of the Standard, and they wanted a "practical" cordage man for President, whom they could control. Mr. Grimwood, Secretary of the Fiber Club, was offered the position, but he declined, believing that he would not be allowed freedom. Vincent P. Travers, a competitor in the firm of Travers Brothers, established in 1871, was selected. Mr. Travers did poorly. Besides burdening the Standard Rope and Twine Company by his oiling machinery, he was accused, — with a good deal of evidence behind the accusation, — of discriminating against the Standard in favor of his own concern, turning the less profitable contracts toward the former and the more profitable ones toward the latter. After he was retired from the Standard, he became Treasurer of Travers Brothers. This concern failed. He became later an employee in a building in New York City.

[3] 1900, S. R. T. Co. Rep. 6.

[4] 1902, S. R. T. Co. Rep. 5.

In September, 1898, certain officers of the Standard Rope and Twine Company formed a selling agency for the purpose of handling the Company's product. The Union Selling Company, as this latter was called,[1] entered into a contract with the officers of the Standard Rope and Twine Company, by which the latter paid 7½ per cent commission on all sales. The contract was undoubtedly burdensome,[2] and pressure was brought to bear, in 1900, to ameliorate its conditions. Subsequently, the terms were changed so that the Cordage Company had to pay its selling agent $225,000 per annum, whether any sales were made or not, and ½ cent on sales in excess of 45,000,000 pounds.[3] This contract was even more onerous.

Competition of the keenest character confronted the Company on every side. The Plymouth Cordage Company, the best managed concern in the trade, with a capital of $1,500,000, was doing a larger business than the Standard with a nominal capital of $20,000,000. The rejuvenated Waterbury, Tucker and Carter, Wall, and Whitlock Companies were increasing their sales at the expense of the Standard. New, well organized mills were springing up all over the country. The McCormick and Deering harvesting machinery companies, too, had all but driven the Standard Company out of the binder twine business. Under these conditions, the Standard Rope and Twine

[1] The President of the Selling Company was Thomas Russell, later President of the Standard Rope and Twine Company. The head of the sales department of the Standard Rope and Twine Company, Charles E. Borden, became Vice-President of the Selling Company. The stock, $500,000, was secured by those close to the management of the Cordage Company. For example, William Barbour, one of the Reorganization Committee of the United States Cordage Company and a Director of the Standard, was a large stockholder in the Union Selling Company. (Montgomery Circular, February 24, 1904.)

[2] This is clearly shown from the following figures, taken from a Stockholders' Committee Report.

	1897	1898	1899	1900
Sales	$3,542,353	$3,100,118	$4,999,275	$4,255,342
Expenses of sales by Company itself	112,711	158,385		
Expenses of sales by Union Selling Company			343,157	294,168

Thompson Committee Report. 1901, S. R. T. Co. Rep. 16.

"Under all circumstances the Committee is of the opinion that it would be a judicious policy not to renew this contract." *Ibid.*

[3] Montgomery Circular, February 24, 1904.

Company sank deeper and deeper into the quicksands. In March, 1904, the price of the first mortgage bonds declined to thirty-nine per cent and the income bonds had a nominal market of three per cent.[1] The stock was quoted at 75 cents a share.[2]

Even in this condition, the officers of the Company continued the struggle. They paid the August, 1904, coupon on the first mortgage bonds, and "made a Macedonian cry to their security holders 'Come over and help us.'"[3] During 1904, the officers tried at various times to hold a stockholders' meeting with a quorum present. Their continued failure shows the feeling of hopelessness in the minds of the stockholders.[4] Finally, on January 25, 1905, Receivers were appointed by the New Jersey Court, on petition of the Vice-President of the Company.

During the succeeding months, various committees were working on a Reorganization agreement. These efforts finally bore fruits in a plan which involved the sale of the assets of the Company to the Standard Cordage Company, and the absolute extinction of the stock of the Rope and Twine Company. This Reorganization plan, presently adopted, reduced the existing securities from over $21,000,000 to a little over $8,000,000, and at the same time provided for over $1,000,000 of new capital. The plan in detail required that the old first mortgage bondholders should surrender their bonds and pay an assessment

[1] It should be remembered that the first mortgage bonds represented actual cash contributed in the last reorganization, and the income bonds represented the funded debt of the bankers at the time of the National Cordage Company's reorganization. Briefly, a banker who took an old first mortgage bond of the United States Cordage Company in liquidation of his notes of the National Company could now sell his $1,000 bond, if he found a customer, for $30.

[2] It is an interesting coincidence that at the very time the Standard Rope and Twine Company was struggling to maintain a position, the old John Good Company's property, — both the machine works and the cordage mill, — were sold at a Sheriff's sale to creditors.

[3] Quotation from *Cordage Trade Journal*, October 6, 1904. XXIX *C. T. J.* 104.

[4] "Extraordinary efforts have been made to secure the attendance of the stockholders, either in person or by proxy, at the Annual Meetings; three adjourned meetings being called last year, at none of which were there enough votes represented to enable the meeting to be held." 1904, S. R. T. Co. Rep. 5.

of $262.50 [1] for each $1,000 bond. In return, they received $850 in new first mortgage bonds, $775 in new income bonds, and $175 in new stock. The old income bondholders surrendered their bonds, and paid an assessment of $52.50 for each $1,000 bond. They received $70 in new first mortgage bonds, $35 in new adjustment bonds, and $335 in new stock.[2] The old stockholders received nothing.[3] The commendable features of the

[1] It was not called an assessment. The phraseology of the plan gave the old bondholders fifty per cent of their holdings in new first mortgage bonds, and sixty per cent in new incomes, "provided and upon condition that the First Mortgage Bondholders *subscribe* at 75 to new first mortgage bonds to the extent of thirty-five per cent of their holdings." For the above subscriptions they would receive "a fifty per cent subscription bonus in adjustment bonds, and a fifty per cent subscription bonus in stock." Reorganization Plan, December 12, 1905, p. 8. A very good digest of the whole plan is given in *The Cordage Trade Journal*, December 21, 1905. XXXI *C. T. J.* 221.

[2] The old income bondholders were offered thirty per cent in new stock if they would subscribe to the extent of seven per cent of their holdings to new first mortgage bonds at 75. For this, they were offered "bonuses" of fifty per cent of their subscription, in new income bonds, and fifty per cent in new stock. Reorganization Plan, December 12, 1905, pp. 8–9.

[3] In a polite circular, under date of October 30, 1905, the Income Bondholders and Stockholders Protective Committee informed the stockholders that, "notwithstanding their earnest, persistent and long continued efforts, they have been unable to obtain any recognition of the stock in any plan for the reorganization of your Company." The stockholders had no committee of their own.

It should be remembered that a very large part of this stock was represented by the old preferred stock of the National Cordage Company, after numerous assessments. For purposes of illustration consider a private investor having bought ten shares of the National Cordage Company's preferred stock of Belmont and Company in 1890. In the reorganization of the National Company, he was compelled to buy twenty per cent more of the preferred stock, all of his holdings becoming second preferred. He would, therefore, come into possession of twelve shares of the United States Cordage Company's second preferred stock, — cost $1,200. He received no dividends. In the reorganization of the United States Cordage Company, the second preferred stock was assessed $10 a share and received $10 a share of the First Mortgage Bonds of the Standard Rope and Twine Company and forty per cent of stock. The investor in question would be assessed $120, — making his actual investment $1,320. He received $120 in the Standard Rope and Twine Bonds and $480 in stock. In the reorganization of the latter Company the stock was extinguished. The bonds were worth thirty-nine per cent and, if retained, would be subject to an assessment. The $120 in bonds represented an actual value to the investor of $46.80. Meanwhile, he would have lost the interest on the investment for upwards of twelve years. Taking this at the rate of five per cent the indirect loss amounted to $780. A man who invested

plan were, of course, the drastic reduction in outstanding securities, and the provisions for new capital.[1] The surprising feature is that the holders of the bonds were willing to come forward and add more capital to an enterprise that had met with such repeated failure. (See table on next page.)

The Standard Cordage Company, which gathered together the fragments of the Standard Rope and Twine Company, proved no more successful than its predecessors.[2] It led a precarious existence, operating only the old Sewall and Day plant, near Boston, and generally conducting its business at a loss. The net deficit had accumulated to over $600,000[3] by 1910. In 1912, the Receivers of the Company ceased the well-nigh hopeless struggle, disposed of the few remaining assets of the Company and entirely liquidated its affairs.

It is not difficult to summarize the unfortunate, but somewhat remarkable history of the cordage consolidation. The manufacture of rope and twine always has been, and still is, profitable. The industry is competitive and open to all. The raw material is bought in an open competitive market and the finished product is sold under conditions of keen competition. Under these circumstances a consolidation of manufacturing companies could be successful only if it had at its command distinctly superior business ability. In this asset, the single necessary condition for success, the National Cordage Company and its reorganized successors were wanting. Although many of the Directors of the National Cordage Company had been able manufacturers when their businesses were restricted to small compass, they failed to understand the responsibilities of a

$1,000 in the first and underlying security of the National Cordage Company would, in 1905, have increased his actual investment to $1,320, and including interest to $2,100. For this he would have stock that was worthless and bonds having a market value of $46.80 and subject to a further assessment.

[1] The reorganization plan was subjected to a searching editorial criticism in the *Cordage Trade Journal* of December 21, 1905, in which it was contended that the plan was not sufficiently drastic. XXXI *C. T. J.* 230.

[2] In January, 1912, its first mortgage bonds, valued by the Reorganization Committee at 75, were sold for $22⅞ (auction sale, January 12). Income bonds were freely offered at $3½, and its stock had no purchaser at a dollar a share.

[3] 1910, S. C. Co. Rep. 1.

	STANDARD ROPE AND TWINE COMPANY					STANDARD CORDAGE COMPANY									
	First Mortgage Bonds	Fixed Charges	Income Bonds	Contingent Charges	Stock	Assessment		First Mortgage Bonds		Fixed Charges	Income Bonds		Contingent Charges	Stock	
						Individual	Aggregate	Old Bondholder	Aggregate		Old Bondholder	Aggregate		Old Bondholder	Aggregate
Bonds, First Mortgage	$2,740,000	$164,400	....	...	..	26¼%	$719,250	$850	$2,329,000	$116,450	$775	$2,123,500	$106,175	$175	$479,500
Bonds, Income ...	....	...	$6,805,330	$340,266	...	.5¼%	357,280	70	476,373	23,819	35	238,187	11,909	335	2,279,786
Stock	....	....	....	....	$11,960,860	. .	...		None	.	....	None	..	....	None
Treasury of New Co.	....	.	...	. .	. .	...	....	. .	627	...	. .	138,313	...	....	40,714
Totals	$2,740,000	$164,400	$6,805,330	$340,266	$11,960,860	.	$1,076,530	. .	$2,806,000	$140,269	..	$2,500,000	$118,084	...	$2,800,000

SUMMARY

	Old	New	Change: Amount	Change: Percentage new to old
Securities bearing Interest	$2,740,000	$2,805,373	+ $65,373	102%
Securities bearing Fixed and Contingent Charges	9,545,330	5,167,060	− 4,378,270	54%
Total Securities	21,506,190	7,926,345	−13,579,845	37%
Fixed Charges	164,400	140,269	− 24,131	85%
Fixed and Contingent Charges	504,666	258,353	− 246,313	51%

large organization. The President and "the manufacturing Director" devoted their attention to aspects of the Company's affairs for which they were untrained, — speculation in hemp and the securities of their Company. The President of the United States Cordage Company was a banker, placed in the position by the group of bankers who had made heavy loans to the Company. He was confessedly unfamiliar with the detail of a manufacturing business and with the cordage industry in particular. Overloaded with indebtedness inherited from the mismanagement of the previous years this organization failed in a year. The President of the Standard Rope and Twine Company divided his attention between the Company and another firm engaged in the same kind of business. Proving unsuccessful, he was succeeded by another man more interested in obtaining a profit for the Selling Agency, in which he was interested, than in the efficient administration of the Standard Rope and Twine Company. And the successors in the management of the Standard Cordage Company were too heavily handicapped by a burden of debt and inefficiently equipped mills to make a successful struggle in a competitive field.

Source Pamphlet Covering the National Cordage Company

Some instructors in Corporation Finance may find it desirable to place in the hands of students reprints of the important documents covering the entire history of one corporation. The Cordage combination seemed best to use for illustrative purposes for various reasons, not the least of which was the variety and wealth of material available and the many phases of finance which its history illustrates. A pamphlet containing twenty-one documents covering the history of the combination from the early pooling agreements to the reorganization of the United States Cordage Company has been prepared to accompany this volume. (Address Harvard University Press, Cambridge, Mass.)

CHAPTER VII

The Westinghouse Electric and Manufacturing Company

Early success of the Westinghouse Electric Company, 167; rapid expansion leading to large fixed assets, 168; the reorganization of 1891, 170; expansion of the industry, 174; over-extension of the Company's finances, 177; receivership, 182; variety of interests, 182; Readjustment Committee's mortgage bond plan, 184; merchandise creditors' plan, 187; difficulties of execution, 190; consummation of the plan, 193; achievements of the plan, 195; comparison of the two reorganizations, 197; later history, 198.

Chronological Summary

1886. Beginning of the Westinghouse Electric Company.
1890. Increase of stock from five to ten million dollars, and Company in difficulties.
1891. Reorganization.
1896. Increase of stock from ten to fifteen million dollars.
1901. Increase of stock from fifteen to twenty-five million dollars.
1906. Issue of convertible debentures.
1907. (April) Attempted increase in the stock of the Company.
1907. (Aug.) Difficulties in refunding.
1907. (Oct.) Receivership.
1907. (Nov.) First plan of readjustment (failure).
1908. (Jan.) Readjustment Committee's mortgage bond plan.
1908. (April) Announcement of failure of mortgage bond plan and proposal of merchandise creditors' plan.
1908. (Sept.) Acceptance of merchandise creditors' plan.
1908. (Nov.) Operation of merchandise creditors' plan.
1908. (Dec.) Discharge of receivers.

The history of the Westinghouse Electric Company is a record of marked achievement in the application of scientific knowledge to practical uses. Beginning as a small business in 1885, the Company has grown for nearly thirty years until its total annual sales are in excess of $39,000,000, and the total assets are over $80,000,000. Yet this growth has not been uninterrupted. Twice in the Company's history it has been

in immediate danger of bankruptcy, and twice it has undergone a reorganization. Both of these embarrassments resulted from the same cause, and both were relieved by the same remedy. Moreover, the cause is typical of the danger which surrounds a growing and profitable business engaged in the production of a commodity that requires a large investment in fixed assets. The remedy resorted to in order to relieve the distress was striking in both cases. Thus the financial history of the Westinghouse Company must be regarded as of great permanent and scientific interest.

In the inventive genius of its founder lay the strength of the Westinghouse Company. It was, in a sense, its weakness too. Great inventive genius, combined with unusual power in forecasting the practical application of technological advances, is frequently combined with an enthusiastic optimism not consistent with the maintenance of a conservative financial policy. The Westinghouse Company has always been strong from the side of technical achievement, but weak from the side of the administration of its finances and its control over the avenues of capital investment. It has been a large business enterprise, from its position in a great and far-reaching industry; a small business in the methods of administration of its own financial policy.

George Westinghouse, Jr., was born in 1846. When not more than ten years of age, he was taken by his father to Schenectady, New York, where he divided his time for the next few years between his father's agricultural implement factory, and the district school. In 1868, young Westinghouse went to Pittsburg with his first important invention, a reversible " frog." Thereafter he devoted himself to the study and commercial exploitation of mechanical and electrical appliances. The real beginning of Mr. Westinghouse's electrical business, as we know it to-day, was in 1886.[1] During the previous year, he became interested in the patents of William Stanley, Jr., which controlled a system

[1] The business was commenced in a small way about 1885-86. Some time later it was transferred to the Westinghouse Electric Company, which assumed an old charter granted in 1872. It is sometimes stated, erroneously, that the business began in 1872.

of electric lighting; and in 1886, he acquired the famous Gaulard and Gibbs patents, which controlled a "transformer system" for alternate current lighting. Two years later, he acquired the Tesla patents, which underly practically all modern polyphase alternating current machinery. At this time it was said that direct current central stations could not deliver their current economically "beyond half a mile in any direction."[1] Mr. Westinghouse's experience with the transmission of gas through pipe lines at high tension and its distribution by means of pressure reducers convinced him that the same principle could be applied to the commercial distribution of electricity by means of high voltage alternating currents. In connection with his patents for alternating current machinery, Mr. Westinghouse is quoted as saying, "A veritable revolution must necessarily follow, as we have perfected plans for its introduction into every city and borough in the United States."[2]

Unfortunately, the revolution to which Mr. Westinghouse alluded involved the tying up of large amounts of capital, not only in the cities themselves, but also in the manufacturing plants that should produce the equipment. The first alternating current generator was installed at Greensburg, Pennsylvania, in 1886;[3] and immediately thereafter, the new business of the Westinghouse Organization grew by leaps and bounds. The Company leased two concerns devoted to the manufacture of electric light appliances.[4] About 1889, it began the manufacture of electric railway equipment on a large scale. In all these fields its business was very active.[5] During the nine months from April 1 to December 1, 1886, the total sales of the Company, including every form of electrical appliance, amounted to less than $150,000; the following year they reached over $800,000 and in 1890, the fifth year of the Company's history, they amounted

[1] Article in *Electrician and Electrical Engineer*, November, 1886.

[2] *Pittsburg Dispatch*, October 31, 1886.

[3] Greensburg Light and Power Company.

[4] United States Electric Lighting Company, capitalization, $750,000; and Consolidated Electric Light Company, capitalization, $1,213,200.

[5] For example, two months after announcing its readiness to supply electric railway car motors, it had orders of over $250,000 on its books.

to over $4,000,000.[1] Behind this startling expansion, there lay hidden elements of insecurity. The development of the manufacturing plant required the expenditure of large sums of money; and as the application of electrical apparatus to commercial purposes was then in its infancy, much of the machinery was, from the very nature of the case, experimental and provisional. Even this machinery had to be made in the Company's own shop.[2] To finance this aggressive policy of expansion, more money was required than the Company had at its disposal. Even the large banks were sceptical. To add to the difficulty, the stock was narrowly held chiefly by Mr. Westinghouse and his associates, and was little known outside of Pittsburg. In the presence of this difficulty, a difficulty created by the great size of the business, the Board of Directors decided to appeal to the stockholders for more capital. In July, 1890, the stock of the Company was increased from $5,000,000 to $10,000,000. The name was changed from the Westinghouse Electric Company to the Westinghouse Electric and Manufacturing Company. At the time, the old stockholders were given the privilege of subscribing to the new stock at $40 a share (par $50). It was stated that Mr. Westinghouse had agreed to take $1,250,000 of the new stock.[3] There seems little doubt that his interest in the business amounted to at least one-fourth of its entire capitalization.

The new capital raised in July, 1890, was not sufficient to meet the emergency. The Company had heavy loans, — of over $2,000,000, — with its merchandise creditors and its local bankers. These loans could be postponed, but they could not be liquidated,[4] so heavy was the Company's investment in fixed capital. By the early winter, heroic measures for relief

[1]

April 1 to December 31, 1886	$141,846.71
Year ending December 31, 1887	847,657.87
Year ending December 31, 1888	1,288,569.41
Year ending December 31, 1889	3,618,379.81
Year ending December 31, 1890	4,289,086.81

(Letter, dated September 24, 1891, of P. F. Kobbe, Treasurer of Westinghouse Company, to Brayton Ives.)

[2] Banker's circular of October 8, 1891.

[3] 51 *Chron.* 52.

[4] Resolutions at Meeting of Board of Directors, April 7, 1891.

seemed necessary, and a committee of local bankers undertook an investigation into the actual worth of the Westinghouse securities. In the meantime, it was suggested that some of the stock be made preferred,[1] and that special inducements be offered the small stockholders to lead them to subscribe to the new form of security. On December 10th, the committee of local bankers reported that the stock was "worth at least $25 per share" (par $50), and decided to loan the Company $500,000, as Mr. Westinghouse requested, but reserved "the privilege of naming the general manager."[2] On the same date, the Board of Directors decided to make $3,000,000 of the $10,000,000 of stock preferred. This stock was part of the recent issue of $5,000,000, and was reserved in the Company's treasury.

Early in 1891, it was rumored that a reorganization was imminent.[3] The floating debt had reached the surprising total of $3,303,611.45[4] (the capital, the year before, was only $5,000,000) and the merchandise creditors were pressing the payment of their obligations. The subscription to new stock had not been a great success; less than a half of the stock offered had been taken by the stockholders.[5] This had netted the Company approximately $1,400,000, less than half of the floating debt. It was necessary to secure the aid of outside bankers, and to this end tentative arrangements were made with a syndicate, managed by August Belmont & Company, which involved the voluntary reorganization of the Company. At the meeting of April 7, 1891, the Board of Directors approved the plan for obtaining new capital, and under date of April 23d, Mr. Westinghouse sent a circular to all stockholders urging them to accept its provisions. "Your officers," he begins, "have for some time been confronted with a condition of affairs which has kept the Company upon the brink of a receivership."[6] He then outlined

[1] 51 *Chron.* 770.

[2] 51 *Chron.* 830.

[3] 52 *Chron.* 322.

[4] Balance sheet, March 31, 1891.

[5] Mr. Westinghouse himself had agreed to take $1,250,000, so that the response of the small stockholders and outside interests was very discouraging. The amount actually subscribed for by the stockholders was exactly $1,780,400. See table A, p. 173.

[6] Circular letter to stockholders, April 23, 1891, p. 1.

a plan of reorganization which, in brief, involved the surrender on the part of stockholders of 40% of their holdings of stock to the treasury of the Company, the 60% retained to be called "assenting." It would carry 7% dividends in preference to the remaining common, or "non-assenting" stock. There was outstanding, as issued stock, $7,250,000,[1] of which a small part was owned by the Company, but pledged for loans. Including this stock that was used as collateral security, the Company had $3,000,000 of stock which had been made preferred, and about $200,000 of the common stock not subscribed for by the stockholders. Through the surrender by the stockholders of 40% of their holdings, the treasury of the Company was still further enriched by $2,700,000 of stock, making the total amount of common stock in the treasury, authorized but unused, $2,900,000. The Board of Directors made $1,000,000 of this amount preferred stock, and thus increased the amount of treasury preferred stock to $4,000,000. The preferred stock was to receive 7% cumulative dividends, in preference to the dividends on all other securities, with the right to participate with the common stock in dividends above 7%. The $1,900,000 common stock remaining in the treasury, and the outstanding common stock of those persons who had given up a part of their holdings, was stamped "assenting." This stock was to receive 7% in dividends, after the preferred stock, but in preference to any dividends on the old common stock 40% of which had not been surrendered.[2]

To accomplish the rehabilitation of the Company, it was necessary to procure new capital. Money was needed to liquidate the floating debt and the merchandise creditors' claims, and also to provide the Company with new working capital. On April 7, 1891, the Board of Directors appointed a Reorganization Committee consisting of August Belmont, of August Belmont & Company; Charles Fairchild, of Lee, Higginson & Company; and Brayton Ives, President of the Western National

[1] In the text, giving a summary of the reorganization, approximate figures only are used. The exact details of the reorganization may be seen from the tables on p. 173.

[2] For further details see tables on p. 173.

Bank, New York.[1] The tacit understanding at the time was that the members of the Committee, in coöperation with Mr. Westinghouse, should insure the success of the reorganization; the members of the Committee themselves agreed to be responsible for the subscription to the preferred stock, to the amount of $3,000,000. A syndicate was formed by the three bankers, but owing to the uncertainty of the electrical industry, and the prevalent scepticism in regard to its future, the bankers were unwilling to purchase the full amount of $3,000,000 of the new preferred stock for public subscription. They did, however, purchase outright, for public subscription, $1,000,000 of the stock. At the same time, the merchandise creditors became participants in the syndicate, in so far as they agreed to take a portion of the remaining $2,000,000 of preferred stock in liquidation of their claims; and other creditors holding over $1,000,000 in notes of the Company exchanged these for the personal note of Mr. Westinghouse, secured by a collateral deposit of the remainder of the preferred stock. In the public offering of the stock by August Belmont & Company, and Lee, Higginson & Company, in their joint circular of October 8, 1891, it appeared as if the whole $3,000,000 of preferred stock was offered for public subscription.[2] In reality, the bankers had arranged to distribute some of the stock taken by the creditors in case the $1,000,000, they had purchased outright should be over-subscribed by the public. This, however, was not the case, as the bankers had some difficulty in securing the subscription to the $1,000,000. In consideration of their services as a Reorganization Committee, and for the underwriting of the $3,000,000 of preferred stock, the bankers received a commission of $125,000 in preferred stock and $125,000 in cash.[3]

The underwriting accounted for only $3,125,000 of the preferred stock. It was the intention of Mr. Westinghouse and the Reorganization Committee to use a large part of the remaining

[1] Resolution of Board of Directors, April 7, 1891. Subsequently ratified at meeting of stockholders.

[2] Circular of October 8, 1891, p. 1.

[3] Minutes of meeting of Board of Directors and memorandum reproduced hereafter. (Appendix, page 201.)

$875,000 preferred stock still in the treasury, and considerable amounts of the treasury "assenting stock," to acquire the outstanding securities of the two "leased" lighting companies. Accordingly, under date of May 16, 1891, Brayton Ives, as Chairman of the Reorganization Committee, offered the stockholders of the United States Electric Lighting Company, 25% of their holdings in new Westinghouse preferred stock, and 50% in Westinghouse "assenting" stock.[1] He enclosed, also, a deposit agreement under the same date. Exactly the same offer was made to the stockholders of the Consolidated Electric Light Company. The acquisition of the stocks of these two subsidiary companies involved the issue of $500,000 in Westinghouse preferred stock and $1,000,000 in "assenting" stock.[2] Altogether $3,642,200 in preferred stock and $5,201,540 in assenting stock was outstanding at the consummation of the reorganization.[3] The details of the reorganization can be seen from the three tables given on the next page.

The plan met with enthusiastic acceptance, and practically all of the stockholders immediately surrendered 40% of their holdings. In fact, it is believed that every stockholder agreed to the plan, except a few who, because of absence from the country, could not be reached. The first dividend of 1¾% on the preferred stock was issued in script, so as not to reduce the working capital immediately. The floating debt was paid off, so that, by February 29, 1892, the "bills and accounts payable" had been reduced to a little over $600,000, while the "cash and bills and accounts receivable" were considerably over twice that amount.

The good results of the reorganization were clearly manifest. The Company had over $3,000,000 in floating debt, nearly $7,000,000 of common stock outstanding, giving a total out-

[1] Letter of Brayton Ives, Chairman.

[2] A memorandum found among some papers explains, in detail, the distribution of the stocks. It is incorporated in full as an appendix for the purposes of historical record. (See p. 201.)

[3] There was also an issue of $650,000 6% bonds of the United States Electric Lighting Company outstanding, which the Westinghouse Company regarded as a part of its own capital liabilities.

TABLE A

Showing Acquisition by Westinghouse Company of its own Stock just Prior to Reorganization

	Old Stock Issued and Authorized		Stock Acquired by Company From old Stockholders	Stock Acquired by Company From Treasury
Stock previously outstanding in hands of public	$5,000,000			
New stock issued by Company:				
George Westinghouse, Jr, subscription	1,250,000			
Other stockholders' subscriptions	530,400			
Total in hands of public	$6,780,400	(40%)	$2,712,160	
Issued and used by Company as collateral for loans	488,500		...	$488,500
Total outstanding	$7,268,900			
Treasury unissued	2,731,100		....	2,731,100
Total authorized	$10,000,000			
Total received by Company:				
From stockholders			$2,712,160	
From treasury				$3,219,600
Total available by Company for reorganization purposes				5,931,760
Remaining "assenting" stock in hands of public				4,068,240
				$10,000,000

TABLE B

Showing Division of Westinghouse Company's Stock into Preferred Stock and Assenting Stock

	Preferred Stock	Assenting Stock
Stockholders		$4,068,240
Company's treasury:		
Company's own treasury ($3,219,600):		
Made preferred by Board of Directors, December 10, 1890	$3,000,000	
Subsequently made assenting		219,600
Received from stockholders ($2,712,160):		
Made preferred by Reorganization plan, April 7, 1891	1,000,000	
Made assenting		1,712,160
Total authorized	$4,000,000	$6,000,000

TABLE C

Showing Distribution of Westinghouse Company's Stock at Time of Reorganization

		Preferred Stock		Assenting Stock
Old stockholders				$4,068,240
Sold by bankers (approximate)		$1,000,000		
Sold to creditors (approximate)		2,000,000		
Commission to bankers		125,000		
Acquisition of United States Electric Lighting Company	(25%)	175,000	(50%)	350,000
Addition issued to acquire same		25,250		49,450
Acquisition of Consolidated Electric Light Company	(25%)	303,300	(50%)	606,600
Additional issued to acquire same		13,600		27,250
George Westinghouse, Jr. (special)				100,000
Total issued		$3,642,150		$5,201,540
Treasury of Company		357,850		798,460
Total authorized		$4,000,000		$6,000,000

(These tables presume the surrender of the entire amount of old common stock in accord with the plan. They also presume the exchange of the entire stocks of the electric light companies. These two changes were not fully accomplished for some time, so that the figures presented here do not coincide exactly with the Company's statements of its outstanding stocks after the consummation of the reorganization.)

standing liability of over $10,000,000, at the end of March, 1891, or just before the reorganization. This involved current interest charges of over $180,000. After the reorganization, there were no corresponding floating debts or interest charges, and the total liabilities amounted to less than $9,000,000, all in stock. The large floating debt had been funded into a permanent capital liability. The Company thus passed successfully through this first reorganization, and emerged even stronger than it was in the years immediately before. This first reorganization of the Westinghouse Company was a remarkable instance of a corporation, with a fairly wide distribution of its stock and known to be on the verge of bankruptcy, which accomplished a drastic reorganization without the aid of a receivership. The trouble was brought on by an optimistic business policy, combined with too rapid investment in fixed capital, and by failure to keep the fluid assets sufficiently large. It was relieved through the voluntary sacrifice by the stockholders of a portion of their shares and the willingness of the bankers and creditors to take preferred stock in an enterprise of unknown future. In brief the floating debt was transferred into a stock liability. The Company's truly remarkable success in consummating the reorganization was due largely to the personality of Mr. Westinghouse,—his hopefulness, his resourcefulness, and his strong personal hold on the stockholders.

The interruption in the business of the Westinghouse Company, because of this early reorganization, was only temporary. In 1893, the Company undertook the contract for the lighting of the Chicago World's Fair, and the following year installed the Tesla alternating current machinery for the new power company at Niagara Falls. In 1895, the Westinghouse Company arranged with the Baldwin Locomotive Works for the joint manufacture of electric locomotives; and, in the following year, entered into a compact with the General Electric Company, for the joint control of patents owned by the two corporations. This pooling agreement ended long and costly litigation. The Westinghouse Company controlled patents for alternating current machinery, and underground trolley systems; but the

General Electric Company controlled a large number of direct current patents, the Edison all-glass incandescent lamp, and over-head trolley. Since this agreement has been observed, the two Companies have worked in mild coöperation.

While the Westinghouse Company was making rapid strides in the extension of its influence over the technology of the electrical equipment, the finances of the Company were undergoing significant changes. In 1892, its outstanding capital stock was $8,735,174; and its book surplus a little over $2,000,000.[1] In 1894, when the Company could be said to be completely on its feet, its capital stock was practically the same; but its surplus had been increased to approximately $4,000,000.[2] The profit for the previous year's operations amounted to $1,600,000. The floating debt was only $500,000, and the Company had no outstanding bonds. It would appear, therefore, that, in the depression following the panic of 1893, when the majority of business houses were experiencing serious difficulty, the Westinghouse Company was enjoying unusual prosperity. This rapid expansion of business presented serious financial problems.

The progress of the electrical industry involved extensive investments of capital in the form of generating stations, transmission lines, and small electric machinery. The financing of these developments was accompanied with great difficulties. Small lighting companies and traction lines had trouble in placing their securities in the local markets, and the conditions of their sale to the private bankers were not always favorable. The equipment companies derived their profit through the promotion of these local enterprises, so that it soon came to be the accepted practice of the Westinghouse Company to take the notes of the local companies secured by a deposit of their bonds and stocks, in part payment for equipment. This helped to solve the financial problem for the small enterprises, but made it all the more difficult for the manufacturer, especially as the notes could be discounted least easily at times of commercial stringency, when

[1] Balance sheet of February 29, 1892. Without allowing for adjustment of small amount of assenting stock.

[2] 1894, W. E. M. Co. Rep.

ready money was most needed.[1] These conditions made it necessary to increase the fixed capital in accordance with the growth of the business. In 1896, the stock was increased from $10,000,000 to $15,000,000, and in 1901, from $15,000,000 to $25,000,000. In 1895, the Company began to issue collateral

[1] The problem has been temporarily solved in an ingenious manner by the General Electric Company, the most important competitor of the Westinghouse. Various finance and operating companies have been incorporated by the General Electric interests, which have general charge of the management of local companies, and the placing of their securities. Among the purely finance companies of this character are the Electrical Securities Corporation and the Electric Bond and Share Company. If, for example, an independent engineer wishes to purchase electrical equipment for a hydro-electric plant in West Virginia, he might buy the machinery from the General Electric Company, paying partially with the bonds and stocks of the projected enterprise. The Electrical Securities Corporation might then take over the securities, deposit them, together with others, with a trustee, and issue collateral trust bonds against them. These bonds would be readily sold to investors. In this way the parent company secures the business upon which it realizes cash, while the managers of the local enterprise are not compelled to dispose of securities at a sacrifice. The details of the plan may be illustrated by taking a case in which the General Electric interests indirectly operate the local company. Suppose it is thought wise to entirely reorganize the small company that supplies light and power to Fort Worth, Texas. The enterprise may be financed by the Electric Bond and Share Company, which will undertake a general supervision of the work through a subsidiary organization, the Southwest Utilities Company. The local company will have the benefit of superior engineering skill and the most modern and efficient machinery. The local Fort Worth Company would pay the Electric Bond and Share Company for its cash advances in its own bonds, preferred and common stocks, and with this cash it would pay the local interests for the old plant, and the General Electric Company for the new machinery. The bonds placed upon the property would represent about seventy to eighty per cent of its cost. These bonds, bearing 5 % interest, could be sold to a bond dealer for about ninety-one per cent, who would in turn distribute them to the public at about ninety-six per cent. Such bonds are often sold without the intervention of bond houses. The preferred stock would be issued for the remaining twenty or thirty per cent of the actual cost. This stock, bearing 7 % interest, could be sold for about 94¾ to bankers who would distribute it in small lots to the public at about par. The common stock would go directly into the treasury of the Electric Bond and Share Company or its subsidiary, and would be held there in the interest of the parent corporation until it acquired substantial value through the increased earning power of the local company. Sometimes, as in the case of the American Power and Light Company, another affiliated corporation of the General Electric, these common stocks of local enterprises are used as collateral for the issue of high interest bearing, short term bonds.

trust bonds; and in 1898, $3,500,000 debenture bonds were sold. In spite of these provisions, "notes payable" grew steadily, until they aggregated $5,000,000, in 1901, and $14,000,000 in 1905. At this point, the Company issued collateral time notes and debenture bonds. Meanwhile, the Westinghouse management had established subsidiaries in Canada, and in many parts of Europe. These foreign ventures secured a great deal of business to the parent Company, but experience has shown them to have been unprofitable.[1] In fact, it may be said that the heavy drain upon the parent treasury made by these foreign subsidiaries was one of the chief causes of the embarrassment that presently confronted the Westinghouse Company.[2]

Mere growth is not necessarily an indication of prosperity. The economist has often pointed out that the return, per dollar of invested capital, often decreases as the total capital investment increases. This law of diminishing returns is clearly exemplified in the history of the Westinghouse Company. In 1894, with a capital of less than $10,000,000, including bonds, the Company made a net profit of $1,640,809.11 [3] or over 16%. This was a year of marked business depression. In 1906, with a capital, including stocks and bonded debt, of $46,566,883, the Company made a profit of $3,162,908.33, or less than 7%. This was a year of marked business prosperity. Or, looked at from the point of view of net profit on gross sales, the Company

[1] 1911, W. E. M. Co. Rep. 12 to 20. Mr. Mather, prompted by the sentiment among the banking interests, gave a detailed and colorless analysis of the foreign subsidiaries.

[2] Another matter, comparatively small in amount, tended to inflate the book value of the permanent assets. It was the treatment of the patent account. In 1893 the patents were carried at $4,378,031; in 1899 at $4,792,181, and finally in the balance sheet of the Receivers' accountants, as of October 23, 1907, at $5,898,620. In contrast to this policy of the Westinghouse Company is that of the General Electric Company. From 1893 to 1898 the General Electric Company carried a stock liability of $34,700,000 partly offset by a patent account of $8,000,000. The Company's earnings were not liberal. In 1898, at the time of increasing prosperity, the stockholders voluntarily consented to a 40% reduction in their holdings and the patent account was marked down 50% to $4,000,000. In 1900 the patent account was reduced to $2,000,000 by charging the difference to profit and loss account and in 1906 to $1.

[3] 1894, W. E. M. Co. Rep.

made a little over \$3,000,000 (\$3,211,781.89) in 1901,[1] on gross sales of less than \$16,000,000, — 20%; in 1906, the profit was some \$50,000 less, on total sales of over \$24,000,000, — 13%. However viewed, the profits were growing relatively smaller, as the business was growing greater. Such a tendency is to be found in practically every manufacturing business as it grows larger and more standardized, and is not to be attributed necessarily to unsound financial policy. Taken in connection with other things, however, the decreasing ratio of profit in this instance was a sign which ought to have pointed to conservatism.

The Company had never been conservative in the matter of dividends.[2] From the first reorganization in 1891 to 1902, 7% was regularly paid on the preferred stock. In 1900, dividends on the "assenting" (common) stock were begun, reaching 7% in 1902. In 1903, the dividend was over 9% on both classes; and from 1904 to 1907, it was 10%. In the year ending March 31, 1907, a year, on the whole, of distinct business prosperity, the Westinghouse Company had a surplus applicable to dividends, after the payment of interest charges, of only \$2,767,963.76. Dividends actually required, \$2,499,555. The small remaining profit and loss for the year was consumed by depreciation on the securities of other companies, held in the treasury, so that the actual business of the year resulted in no addition to the permanent surplus account.[3]

[1] This is the earliest recent year for which I find the total sales published. During the early years of the company's history, from 1887 to 1891, the profit was 14% on gross sales. (Letters of Deloitte, Dever, Griffiths & Co. of September 25, 1891 and Treasurer P. F. Kobbe quoted, *supra*, p. 168.)

[2] Below is a record of high and low quotations of the preferred and common stocks (par \$50 in both cases), and the dividends paid for the years directly before and after the receivership.

	1903	1904	1905	1906	1907	1908	1909	1910
Preferred stock:								
High	112	99	98¼	94	80	62½	72½	65
Low	80	90	93¾	81	30	29	55	55
Div.	10⅝%	10	10	10	10	0	5¼	10½
Common stock (assenting):								
High	110½	92¼	92	88	77	47	45	41¼
Low	65	76½	76	73	16	19	37	24¾
Div.	9¾	10	10	10	10	0	0	0

As practically all of the old common stock, prior to the reorganization of 1891, had been changed into assenting stock, I shall hereafter in the narrative refer to this assenting stock as common.

[3] This is strictly true; but the surplus was increased about \$32,000, owing to a profit of \$84,205, realized on sale of some Garrison Alley, Pittsburg, real estate

These were the economic conditions behind the history of the Westinghouse Company. They are shown clearly from the two tables, given on the next two pages, in which the financial history of the Company is epitomized. On the whole it may be said to have suffered from too much prosperity. As a business grows and expands, the managers are apt to look at the increasing volume of sales, and to remain blind to the decreasing ratio of profit. Business was offered on every side. Mr. Westinghouse saw the industrial growth of the country in terms of the increasing application of electricity to the arts. He failed to realize the tremendous economic significance involved in the fixation of large amounts of capital in electrical equipment. He failed, moreover, to note that a business of large magnitude, even though its credit be excellent, must be fortified by considerable reserves in the form of fluid assets not affected by the ordinary fluctuations in the demand and supply of money. Mere bank loans, because of their quick maturity, will not supply the need.

During 1906 and 1907, the affairs of the Company moved rapidly toward a crisis. Its loans were obtained with increasing cost and increasing effort. At the close of 1905, the bank paper and merchandise notes and accounts amounted to well over $16,000,000.[1] On January 23, 1906, the Company offered $15,000,000, convertible debentures at 98%. These were underwritten by Kuhn, Loeb and Company, and netted the Company

which had increased much in value while held by the Company. This was, of course, not a profit derived from the actual business of the Company, and could not be regarded as surplus earnings. If one takes into consideration the business of the seven months just prior to the receivership, from April 1 to November 1, 1907, and, by interpolating over the five preceding months, reaches figures for the year's business just prior to the receivership, the results are even more discouraging. It appears that the total earnings aggregated over $5,000,000, — the largest for any twelvemonth in the Company's history. Yet of this large amount exactly half was paid out in interest on floating and funded debt and the other half in dividends. Practically nothing would be credited to surplus. This estimate is made by allowing the smallest rate for interest on floating debt, and not including the accrued dividends on the new stock. For details of the estimate, see table on next page.

[1] Balance sheet of November 30, 1905, copied on circular to stockholders, January 23, 1906.

	Year Ended March 31							Seven Months Ended Oct. 31, 1907
	1901	1902	1903	1904	1905	1906	1907	
Sales: Shipments Billed	$15,908,154.20	$18,875,341.32	$23,951,129 38	$23,385,787.48	$20,239,066.47	$24,081,600.91	$33,026,240 35	$22,265,322.93
Cost of Sales: Includes all Selling, Administration, and General Expenses	12,707,166.75	15,483,384.86	19,292,665 33	19,249,288 29	18,107,906.05	21,390,058.51	28,846,665.05	19,334,540.28
Net Earnings	$3,200,987.45	$3,391,956.46	$4,658,464 05	$4,136,499.19	$2,122,160.42	$2,691,542.40	$4,179,575.30	$2,930,782.65
Other Income	333,604.28	244,199.17	172,220.74	582,123.48	910,828.44	959,785.62	1,256,334.91	869,833.31
Total Income	$3,534,591.73	$3,636,155.63	$4,830,684.79	$4,718,622.67	$3,032,988.86	$3,651,328.02	$5,435,910.21	$3,800,615.96
Less: Inventory Adjustments, inactive Apparatus and Material Scrapped, Bad Accounts and Extraordinary Items of Expense Charged to Income — Average per Annum During Period	322,809.84	382,972.79	485,832 04	474,187.59	410,466 62	488,419.69	669,878.93	717,393.88
Net Income Applicable to Interest and Dividends	$3,211,781.89	$3,253,182.84	$4,344,852.75	$4,244,435.08	$2,622,522.24	$3,162,908.33	$4,766,031.28	$3,083,222.08
Operating Ratio (%)	79.88	82.03	80.55	80.38	89.47	88.82	87.35	86.84
Percentage of Gross Sales Available for Interest and Dividends	20.19	17.23	18.14	18.15	12.96	13.13	14.43	13.85

STATEMENT OF CONDITION OF COMPANY, YEARS ENDING MARCH 31

For the sake of brevity I have noted condition of company only for every third year from 1892 to 1900

	Feb. 29, 1892	March 31, 1894	March 31, 1897	March 31, 1901	March 31, 1902	March 31, 1903	March 31, 1904	March 31, 1905	March 31, 1906	March 31, 1907	Oct. 31, 1907
Assets:											
Cash	$87,460	$325,694	$330,193	$801,790	$1,555,431	$1,312,644	$2,048,630	$3,290,315	$6,938,899	$1,238,462	$2,983,709
Accounts and Notes Rec'ble	1,439,364	2,718,606	1,647,754	6,400,398	7,441,962	8,852,482	8,678,561	6,585,078	7,523,964	10,071,136	13,567,160
Current Assets	1,526,824	3,044,301	1,977,948	7,202,188	8,997,393	10,165,126	10,727,191	9,875,394	14,462,864	11,309,599	16,550,870
Raw Materials, completed Work and in Progress	445,322	1,545,472	1,636,612	5,372,080	6,951,725	8,241,123	8,657,447	8,607,244	11,919,956	17,319,365	17,458,410
Total Working Assets	$1,972,146	$4,589,773	$3,614,560	$12,574,269	$15,949,119	$18,406,250	$19,384,639	$18,482,638	$26,382,820	$28,628,964	$34,009,281
Property and Plant	5,209,766	5,730,687	7,529,782	11,164,740	11,776,719	12,771,405	15,206,810	16,432,344	18,027,784	18,205,247	19,878,345
Investments	5,346,785	4,401,853	6,820,952	5,287,832	6,166,690	7,407,716	13,255,582	20,865,983	22,619,572	23,622,736	29,491,776
Fixed Assets	10,556,551	10,132,541	14,350,735	16,452,572	17,943,409	20,179,121	28,462,392	37,298,327	40,647,356	41,827,983	49,370,121
TOTAL ASSETS	$12,528,697	$14,722,314	$17,965,295	$29,026,842	$33,892,530	$38,585,371	$47,847,032	$55,780,967	$67,030,177	$70,456,948	$83,379,403
Liabilities:											
Notes Payable	500,503	814,233	1,606,658	4,741,000	5,185,000	6,524,000	9,374,000	14,782,000	7,157,000	8,703,448	9,209,766
Current Accounts	199,694	311,749	484,534	1,269,489	1,259,542	2,437,007	1,418,877	1,354,742	2,324,710	2,152,838	5,031,996
Current Liabilities	700,197	1,125,983	2,091,192	6,010,489	6,444,542	8,961,007	10,792,877	16,136,742	19,481,710	10,856,286	14,241,762
Debenture Certificates	273,512	207,685	194,560	3,350,000	3,200,000	3,050,000	2,679,000	2,679,000	2,600,000	2,278,000	1,969,000
Collateral Notes	...	....	590,000	...	...	....	....	....	6,000,000	6,000,000	8,702,702
Bonds	650,000	550,000	350,000	...	....	...	...	..	12,968,183	15,000,000	18,500,000
Funded Liabilities	923,512	757,685	1,134,560	3,350,000	3,200,000	3,050,000	2,679,000	2,676,000	21,568,183	23,278,000	29,171,702
Capital Stock	8,735,174	9,016,596	12,337,879	14,809,666	18,025,526	18,029,150	22,493,050	24,998,700	24,998,700	24,998,700	27,936,815
Surplus	2,169,813	3,822,049	2,401,664	4,856,686	6,222 461	8,545,214	11,882,105	11,966,524	10,971,584	11,323,961	12,029,122
TOTAL LIABILITIES	$12,528,697	$14,722,314	$17,965,295	$29,026,842	$33,892,530	$38,585,371	$47,847,032	$55,780,967	$67,030,177	$70,456,948	$83,379,403
DEDUCT. FROM ABOVE TABLE:											
Gradual Fixation of Capital:											
a. Excess of Current Assets over Current Liabilities	$826,627	$1,918,318	$113,243 *d*	$1,191,700	$2,554,851	$1,204,120	$65,685 *d*	$6,261,349 *d*	$4,981,153	$453,312	$2,309,108
aa. Percentage of Current Liabilities to Current Assets	46%	22%	106%	83%	71%	88%	101%	163%	66%	96%	86%
b. Percentage of Current Assets to Total Assets	12%	34%	11%	25%	27%	26%	22%	18%	22%	16%	20%
c. Percentage of Current Liabilities to Total Liabilities	6%	8%	12%	21%	19%	23%	23%	29%	14%	15%	17%
Decreasing Conservatism:											
d. Percentage of Net Income to Capital Stock[1]	....	18%	....	22%	18%	24%	19%	10%	13%	19%	11%
dd. Percentage of Net Income to Total Assets	....	11%	....	11%	10%	11%	9%	5%	5%	7%	4%
e. Percentage of Annual Charge for Surplus to Capital Stock	....	12%	....	....	7%	13%	15%	0.33%	− 4%	1%	3%
ee. Percentage of Annual Charge for Surplus to Total Assets	....	7%	....	....	4%	6%	7%	0.15%	— 1%	0.5%	0.8%

[1] Note here the law of diminishing returns (for figures of net earning see previous table). Exact figures prior to 1901 not available.

$13,694,028.19.[1] This new capital cost the Company, including annual charges to discount, 5.8%. In spite of the issue of bonds, however, the floating debt rose steadily during the year, and by March 31, 1907, it amounted again to well over $10,000,000.[2] On April 26, 1907, the Company sent a circular to all stockholders, offering subscriptions to 100,000 new shares of stock at $75 (par $50 a share). It was the intention of the management to maintain the 10% dividend; this being the case, the $7,500,000 secured from the stockholders' subscriptions would have cost the Company 6.7%. As a matter of fact, the subscription was a partial failure, Mr. Westinghouse and one or two other large stockholders alone coming forward. In all, only about $2,500,000 were obtained.[3] In the presence of this ominous condition, of a rapidly maturing floating debt of $14,000,000, with credit extended in every direction, the sharp crisis of the autumn of 1907 came suddenly upon the Company. The banks could extend their accommodation no further, and the merchandise creditors pressed their claims for payment. On the advice of a committee of the Pittsburg Clearing House, the Directors, on October 23d, applied to the United States Court for Receivers.

It must be remembered that there were four distinct interests to be considered, during the succeeding months, when a reorganization of the Company was contemplated. The merchandise creditors had merely open accounts with the Company; in a few cases, these were represented by interest bearing notes. Their claims amounted to approximately $5,000,000.[4] The

[1] In Haskins and Sell's Report to the Receiver occurs the significant statement, "$1,305,971.81 represents discount and expenses incurred in connection with the sale of the Company's Convertible Sinking Fund Gold Bonds." (Haskins and Sells Report, December 17, 1907, p. 5.) The greater part of this represents underwriting commission of which the stockholders received only $300,000. (The difference between 98 and 100.)

[2]

Notes (bank and merchandise paper)	$8,703,448
Current Accounts	2,152,838
Total	$10,856,286

[3] Total amount subscribed for was 33,066 shares, netting $2,479,950.

[4] These and succeeding figures are taken from Haskins and Sells Report to the Receivers, General Balance Sheet, October 23, 1907. Digest, last column in table on p. 181.

banks held short term notes, amounting to approximately $8,000,000.[1] These bank loans were very widely held; a large part had been negotiated by New York and Boston brokers, and were held by small banks from Maine to California. The holders of the funded debt, whose interests would be endangered by a drastic reorganization, had claims amounting, in all, to over $29,000,000.[2] And finally, the stockholders, practically all of whom had actually paid into the Company more than the par value of their holdings, had a total outstanding stock interest of about $28,000,000.[3]

On November 13, 1907, hardly three weeks after the Receivership, the officers came forward with their first plan of adjustment. It was approved by the local bankers and manufacturers in Pittsburg, whose own interests were coincident with the continued prosperity of the Westinghouse Company. The plan required that the holders of the floating debt of the Company should fund their obligations by taking one-third in 5% convertible bonds at 90% of their face value; one-third in 6% notes running from one to three years, and one-third in assenting stock at its par value.[4] When the plan was proposed to other creditors, it was very coldly received, especially by the banks and manufacturers in the West. The plan proposed that the creditors should become partners, and they had no intention of accepting any such compromise, unless it came as a last resort. As a matter of fact, the plan was more favorable to the banks than the one they were finally compelled to accept, since the discount on the bonds would more than offset the reduced selling price of the stock. Their reluctance shows that the serious condition of the failure was not realized until some time later.

Early in December, the various creditors of the Company agreed upon the formation of a Readjustment Committee, with a

[1] $7,919,000.

[2] Not counting $850,000 bonds of the Walker Company, not a direct liability of the Westinghouse Electric and Manufacturing Company.

[3] $27,938,100.

[4] Circular of January 22, 1908. Letter of Kuhn, Loeb and Co., November 21, 1907. This plan was conceived by Mr. Westinghouse. The fact that the final Merchandise Creditors' plan so closely resembled this first tentative plan is strong evidence of Mr. Westinghouse's grasp of the situation.

membership largely self-appointed. Mr. James N. Jarvie was Chairman of this committee, and the other members represented banking interests in Pittsburg, New York, Boston, and Chicago. On January 20, 1908, it came forward with its "Plan for the Adjustment of Debt." [1] As this plan was the first widely discussed attempt to rehabilitate the finances of the Westinghouse Company, it deserves careful attention.[2] Its central feature was the creation of a large first mortgage upon the entire property of the Company. The holders of the funded and floating debt were to exchange their obligations for the bonds covered by this new mortgage. The mortgage was to be for $35,000,000, of which approximately $20,000,000, was covered by bonds convertible into stock, at $62.50 per share. The holders of the $2,000,000 in debenture certificates were to receive the new convertible mortgage bonds as a substitute for their notes. The outstanding floating debt was to be funded into mortgage bonds, covered by the same indenture, but not convertible into stock. The distribution of the new bonds can be shown at a glance from the following table:

New First Mortgage Bonds

Old Securities		Convertible	Non-convertible
Convertible debentures	$18,500,000		
Debenture certificates	1,969,000	$20,469,000	
Floating debt (approx.)			$14,531,000
Total			$35,000,000

In addition to the issue of bonds the plan proposed to issue $7,000,000 of new "assenting" stock.

At first, the plan met with a hearty reception on all sides, and its consummation seemed probable. The banking interests were especially favorable. Kuhn, Loeb and Company [3] advised the convertible bondholders to exchange their debentures for the new mortgage bonds on the ground of better security and the

[1] The plan had "leaked out" at an earlier date, as the main provisions were outlined in the *New York Times* several days before, and in the *Commercial and Financial Chronicle* of January 18, 1908; 86 *Chron.* 174.

[2] See Circular of January 20, 1908, and outline in 86 *Chron.* 233.

[3] Circular letter of January 21, 1908, to known holders.

lower ratio of convertibility.[1] Similar reasons were advanced to holders of the debenture certificates. In the meantime, the securities of the Company declined to low points on the markets,[2] and the various creditors began to realize that it would be difficult to sell the new stock.[3] It was upon the sale of this new stock that the Company relied to obtain the necessary additions to its working capital. Every member of the Committee recognized that, unless additional working capital should be obtained, the Company could not be relieved of its present distress, and another receivership would soon follow, to the irreparable harm of the Company's credit and securities. By the middle of February, 1908, it was clear that the plan could never become operative, though sufficient amounts of the funded and floating debt would probably be deposited. Of all interests involved, the stockholders could best be relied upon to supply new capital, because of their more direct interest in the permanent welfare of the Company, but they were unwilling to come forward in the emergency, if a heavy mortgage were to be placed on their property. In other words, the stockholders, even though their interests were junior to all the others, actually occupied the pivotal position. Accordingly on April 2, 1908, the Committee sent to all depositors under their Plan of Adjustment, a brief letter, stating that although a majority of the holders of the funded debt had deposited their securities in accordance with the agreement, it was considered wise to set it aside, and to try to agree upon a modified plan.

Negotiations looking toward a successful reorganization were much more complex than was indicated by the somewhat prosaic printed circulars, which, from time to time, reached the eyes of the public. The failure of the Company had been brought about by the policy of the Westinghouse management in securing

[1] The outstanding debentures were convertible at $100, or 200 %, par value being $50.

[2] *Supra*, p. 178, note.

[3] According to the expectation of the Committee, the old stockholders would subscribe for the new stock to the extent of 25 % of their holdings. "As a majority of the stock is held by brokers as collateral for loans," said the *Chronicle*, voicing the opinion of the Committee, "said bankers, it is believed, will see that the subscription (practically an assessment) is paid." 86 *Chron.* 233.

new business and borrowing money to finance it. Mr. Westinghouse himself, through his untiring energy and great optimism, was the actual power in the business. In the emergency he had turned to all quarters for succor, borrowing every available cent. When the crash actually came he maintained the same hopefulness and the same lack of conservatism. Opposing him were the various creditor interests, which, although affected by the contagious optimism of Mr. Westinghouse, were concerned primarily in the relief of the present emergency, and the immediate payment of their obligations. Thus in the background of the long and tedious negotiations, of which only rumors reached the public ear, lay the conflict of interests between the generous hope of the founder in the wonderful future of his business, a future not to be embarrassed by over-conservatism or delay, and the stern practical necessity that confronted the creditors of forcing the payment of debts past due.

Specific differences aggravated the dissention. The foremost among them concerned the policy toward the foreign subsidiaries. Beginning in 1889, and particularly since 1899, the American Westinghouse Company had been active in establishing foreign manufacturing companies, and advancing large amounts of capital to them. With the single exception of the Canadian Company, every one of these subsidiaries had proved unprofitable.[1] They were proving especially unprofitable during the period of the receivership and especially urgent in their demands on the parent Company. The Jarvie Committee steadily refused to permit the deflection of capital toward these enterprises, while Mr. Westinghouse took the position that they must be protected at all hazards. Another point of difference lay in the financial policy. The Jarvie Reorganization Committee withheld its consent from any plan which did not insure the Company against a repetition of the present difficulties. The members of the Committee believed that the present embarrassment was an outward sign of the fundamental lack of conservatism shown by the management. They maintained the

[1] See Mather's rigorous analysis of the foreign subsidiaries in his annual report to the stockholders for the year ending March 31, 1911. 1911, W. E. M. Co. Rep. 12.

position that a permanent solution was possible only through the establishment of a new financial policy, having as its basis the conservation of a large fund of fluid assets. They looked toward a permanent rehabilitation of the Company's credit as the first premise of any plan of reorganization. The crux of the problem was the imperative need of new working capital. The members of the Committee insisted that some one must furnish sufficient money, not only to weather the present crisis, but to provide for the needs of the future. Mr. Westinghouse sought, by every means in his power, to induce the members of the Committee to accept plans which looked toward immediate relief. His desire was to extricate the Company from the present entanglements, with the least sacrifices on the part of the stockholders, and the least advances of actual money. He saw nothing fundamentally wrong in the past financial policy of the Westinghouse Company, and looked hopefully to the future for relief from its present difficulties.

In the intent of their position, the members of the Jarvie Committee were obdurate. Other committees were formed to coöperate with them. A Merchandise Creditors', an Employees', and a Stockholders' Committee were each constituted to help create a harmony of interests. The members of the Jarvie Committee, however, held the whip hand, since by enforcing their claims at law, the creditors could compel a sale of the property, and a drastic reorganization in which the stockholders would suffer most. Negotiations between the various parties consisted in the submission of one plan after another to this Committee, and the rejection of all plans as either impractical, or else not furnishing enough new capital. Into the details of these negotiations we need not enter.

Toward the end of March, the various parties finally agreed upon an arrangement which involved the funding of practically the entire debt, much of it into stock, and the cash subscription to $6,000,000 of new common stock. The plan, which was agreed upon by all the parties, came to be known as the Merchandise Creditors' Modified Plan. It was so named because the greatest sacrifice seemed to come from the merchandise

creditors, and because the working out of the details was largely vested in Joseph W. Marsh, Vice-President of the Standard Underground Cable Company, the Chairman of the Merchandise Creditors' Committee. The important parts of the plan were worked out by all parties together, so that, in reality, this Committee had no more to do with it than the other committees. In the plan, the Merchandise Creditors were looked upon to take new stock in liquidation of their claims. And if it could be known that they voluntarily consented to become partners in the enterprise, the bank creditors and the old stockholders would be the more willing to subscribe to the new stock. This point was much emphasized in the succeeding campaign, in the effort to induce the stockholders to come forward with their subscriptions. "The Merchandise Creditors' Committee have shown their confidence in the Company and its future by undertaking to secure the exchange of at least $4,000,000 of the Company's floating debt for "assenting stock" at par. They, however, imposed the condition that the remaining $6,000,000 of the $10,000,000 of subscriptions required to terminate the receivership, and place the Company in a safe position shall be furnished by the stockholders."[1] In a circular letter, dated April 6, 1908, the Merchandise Creditors' Plan was made public. Its main provisions were: (*a*) The settlement of the $4,000,000 of merchandise debt by the issue of new "assenting" or common stock at par. (*b*) The subscription of $6,000,000 of new stock by the old stockholders at par. (*c*) The conversion of the bank debt into new stock, convertible long term bonds, and notes running for an average of at least five years. The old bonds and short term notes were undisturbed.[2] The striking feature of the plan was its simplicity. Only the holders of the floating debt were affected, a large part of whom had already consented to the terms of the plan. No mortgage was created and no change was contemplated in the security of the older obligations. The greatest strength of the plan, perhaps unusual among industrial reorganizations, was the change of floating debt into new stock, with the

[1] Stockholders' Committee Circular of April 8, 1908, p. 3.

[2] Merchandise Creditors' Circular of April 6, 1908; Outline in 86 *Chron.* 922.

consequent reduction of fixed charges. The greatest weakness lay in the difficulty of inducing stockholders to take up their allotment of new stock, since the securities of the Company were then selling considerably below their par value, and the general business conditions were far from satisfactory. From every point of view of financial policy, the plan was a vast improvement over the earlier one, as is seen from the following comparison: —

COMPARISON OF FIXED CHARGES UNDER THE TWO PLANS

The figures for the year 1911 are taken for this comparison, inasmuch as, under the mortgage bond plan, the first sinking fund payment would be payable in that year.

Mortgage Bond Plan		*Merchandise Creditors' Plan*	
Interest on Bonds (based on $33,000,000 outstanding.)	$1,650,000.00	Interest on Convertible Bonds and Debentures (based on $24,500,000 outstanding after 1st Sinking Fund Payment due Dec. 31, 1907 is made	$1,225,000.00
Interest on Collateral Notes	500,000.00	Interest on Collateral Notes	500,000.00
Sinking fund on bonds. (First payment due July 1, 1911 — cumulative if not earned)	1,100,000.00	Interest on new notes not to exceed	225,000.00
		Sinking Fund on Convertible Bonds	500,000.00
	$3,250,000.00		$2,450,000.00

COMPARISON OF EXTENT OF READJUSTMENT UNDER THE TWO PLANS

Comparison of the two plans in respect to the classes of Creditors whose consent is required to a change in the form of their debt or in the nature of their security.

Mortgage Bond Plan		*Merchandise Creditors' Plan*	
Convertible Bonds outstanding	$18,500,000.00	Merchandise Debt	$4,356,042.68
Debenture Certificates	1,969,000.00	Bank Debt	7,919,000.00
Merchandise Debt	4,356,042.68		
Bank Debt	7,919,000.00		
Total of debt to be converted into Mortgage Bonds	32,744,042.68		
Collateral Notes whose holders must consent to change in security	8,702,702.70		
Total debt to consent	$41,446,745.38	Total debt to be converted	$12,275,042.68

COMPARISON OF AMOUNT OF NEW WORKING CAPITAL UNDER THE TWO PLANS

Comparison of the two plans as to new stock to be issued for cash or cancellation of debt.

Mortgage Bond Plan		*Merchandise Creditors' Plan*	
New stock	$7,000,000.00	New stock at least ...	$10,000,000.00

As soon as the plan was formally published all the Committees set to work to secure its consummation. The Merchandise Creditors' Committee had the task of inducing all the holders of the small accounts against the Company to transform their debts into stock. The Committee pointed out that this stock would be very valuable through the benefits resulting from the operation of the new plan.[1] In the background lay the covert threat that the new management would not patronize, in the future, those dealers who refused to help the Company in the present emergency. The Westinghouse Company was a large consumer of raw and semi-manufactured merchandise. It was, therefore, for the obvious benefit of the supply houses to place the Company in a position to continue and expand its business at the earliest possible moment. The motives of self-interest appealed strongly to the merchandise creditors, who accepted the plan almost unanimously, and surrendered their claims in return for stock.[2]

The bank creditors proved more difficult to deal with. A very large part of the outstanding notes had been negotiated by brokers and bankers, and were held by small banks. The Security Investment Company, a finance Company organized to obtain money for the Westinghouse Company, had also heavy and wide-spread obligations, all of which ultimately based on the Westinghouse assets. The proposed Merchandise Creditors' Plan for funding these loans involved indeed an option. The banks were required to take half of their claims in convertible bonds, similar to those outstanding. Of the other half of the claim any bank was permitted to take either three-fifths in notes maturing in four, five, and six years respectively, and the other two-fifths in stock at par, or the entire half of the claim in fifteen

[1] Merchandise Creditors' Circular to creditors of April 6, 1908.

[2] By July 1, 1908, a total of $4,135,912 out of $4,356,043 in all. Circular of Readjustment Committee dated July 1, 1908.

year notes.[1] A third option was afterward suggested, which permitted a bank to take stock at par for the entire second half of its claim. All notes and bonds bore 5% interest.[2] The small banks, far removed from the seat of the trouble, saw no advantage for them in any of these proposals. They did not care for the stock, nor did they look with favor upon funding their paper into bonds, then selling well below par, and into long term notes that could be disposed of only at a sacrifice. The larger New York banks, particularly the Park, Chase, and the National Bank of Commerce, were no more enthusiastic, nor was the New York Life Insurance Company, which owned a considerable volume of Westinghouse notes. These large institutions held out obstinately against the proposed plan, and did not give their consent to it until the autumn [3] when the rise in market value of the stock made it appear that they might derive a profit through the exchange of their notes into bonds and stock. The smaller banks were induced to agree to the plan, largely through the efforts of various members of the Jarvie Readjustment Committee, who represented to them that the plan could be consummated only through their united coöperation.

The third class of people affected, the stockholders, were even more difficult to handle. Excluding the personal holdings of Mr. Westinghouse, and those of the Security Investment Company, the average stock interest in the Company was 83 shares (par $50.00) or about $4,150, and the number of stockholders about four thousand. To reach this multitude of stockholders, and induce them to come forward in the hour of need was not an easy matter. Many of the stockholders were themselves temporarily embarrassed. Many, especially those who had purchased the stock at high figures, were "angry and disgusted

[1] Very few of these notes were given, — less than $100,000, — so that almost all of the banks took some stock.

[2] The options may be seen from the following table:

	Bonds	Fifteen Year Notes	Four, Five, and Six Year Notes	Stock
First option	50%	....	30%	20%
Second option	50%	50%	....	....
Third option	50%	....	....	50%

[3] 87 *Chron.* 1014.

with the past management, and professed to have no confidence that the management would be different in the future." [1] The Stockholders' Committee, whose duty it was to secure the subscriptions from the smaller holders, sent out letter after letter in the endeavor to arouse their interest. Some of the letters were conciliatory, and touched on the duty of the stockholders as real owners of the Company; some appealed to the sense of personal advantage, suggesting the probable enhancement of price of the new stock that would follow the consummation of the reorganization. Some, particularly those toward the end of the summer, were threatening in character, stating that unless the full stock subscription was soon realized the Reorganization Committee would force a sale of the property and wipe out the stockholders.[2] "If you do not subscribe," wrote George Westinghouse, in a circular to all stockholders, "you in effect vote for a sale of the property by the creditors and thus, the elimination of all stock interests." [3] Independent bankers, even, solicited subscriptions from stockholders.[4]

All these efforts finally achieved the desired results. The merchandise creditors were uniformly successful. The bankers showed a willingness to fund their notes and exchange a relatively large part for stock. The underlying creditors of the Security Investment Company, — largely the banks, — enabled the Investment Company to subscribe to $1,325,000 new stock, and George Westinghouse himself subscribed through the Invest-

[1] Quotation taken from circular letter of Joseph W. Marsh (Chairman Merchandise Creditors' Committee) to stockholders dated October 26, 1908.

[2] For example, in a letter of October 26, 1908, to the non-subscribing stockholders, Mr. Marsh, of the Merchandise Creditors' Committee, tried to be both pathetic and forceful. After comparing the present condition of the Company to a "valuable horse which your hostler had maltreated," he says, "can you, as a fair or sensible business man (or woman), hesitate any longer in doing your just share to save yourself from complete loss." "This is the last chance and certainly my last appeal to the stockholders." There were a number of "last calls" before the expiration of the subscription period.

[3] Letter dated April 28, 1908.

[4] A stock exchange house, Dominick & Dominick, advertised that they would carry the smaller stockholders' subscriptions for six per cent interest and one per cent commission. Although the offer was widely known not more than five or six people took advantage of it.

ment Company to $1,500,000.[1] The employees, in whole hearted loyalty to the Company and its founder, came forward with a subscription of approximately $600,000. The general stockholders had, by June 23d, subscribed to approximately $2,250,000 of new stock, but these subscriptions were confined to the larger holders. Experience has shown that the small stockholder seldom assumes the responsibilities which his ownership of the corporation implies. He is inclined to look at the market value of his holdings, rather than the interests of the business of which he is part owner. This fact is the weakest point in diversified stock ownership. Had the Merchandise Creditors' Plan proposed to establish a second preferred stock, to represent the new subscription, which should have preference over the old "assenting" stock, the plan would have been fairer to those of the stockholders who came forward in the hour of need. Legal difficulties stood in the way of this method of solution.

On September 25th, the Readjustment Committee, after a long conference with their attorneys, authorized the statement that they would formally accept the Merchandise Creditors' Plan in place of their earlier one. They stipulated, however, that the new plan should not become operative until the full $6,000,000, had been subscribed by the stockholders, and the bank creditors had consented to fund their notes. The time for the subscription to the new stock was again extended to October 27th. Even the prospect of a speedy termination of the receivership did not bring the small stockholders to a realization of their obligation.[2] On October 1, 1908, some eighteen hundred stockholders, out of a total of four thousand, had refused to pay their pro rata subscription. In the meantime, the number of employees who had contributed their savings to help the Company had increased to five thousand,[3] an interesting reflection on the

[1] This made the subscription of Mr. Westinghouse and The Security Investment Company, $2,825,000. As the two together held about half the old stock, this figure shows that they did not, as many believed at the time, subscribe to much more than their proportion of the $6,000,000 required of the stockholders before the plan should become operative.

[2] 87 *Chron.* 815.

[3] Letter of George Westinghouse, October 1, 1908.

loyalty and insight of the workers, as compared with the owners of a large corporation. On November 20, 1908, a little over a year after the appointment of the Receivers, the Readjustment Committee declared the Merchandise Creditors' Plan operative and early in December, the Company was taken out of the hands of the Receivers.

It is profitable to consider at this point, the conditions which were instrumental in enabling the Readjustment Committee to consummate this truly remarkable reorganization. The operation of the Merchandise Creditors' Plan had turned on the success with which $6,000,000 could be raised by the sale of the stock, at par, to the old stockholders. The market price, during all the time, was considerably under par, so that any subscription to the stock, meant some measure of sacrifice of immediate self-interest, for the interest of the Company. The final allotment of this indicates the difficulty to be encountered in any reorganization, which depends upon the concerted action of an extended group of small stockholders. Another significant

Stockholders		$2,404,550[1]
Security Investment Company, Creditors of (mostly banks)	$1,540,300	
Advanced by Pittsburg banks to enable George Westinghouse to complete a subscription for $3,000,000 of new stock for the Security Investment Company	1,502,775	3,043,075
Employees		611,250
		$6,058,875

feature of the reorganization was the attitude of the bank creditors, who held upwards of $8,000,000 of the Westinghouse Company's notes. The Merchandise Creditors' Plan had offered them various alternatives, all involving the funding of half their claims into long term bonds, and differing in the amounts of stock subscription required for the other half. About $4,000,000

[1] During the period from June 22d to November 20th, as a result of all the beseeching letters sent to the two thousand odd non-subscribing stockholders, only $190,250 was obtained. The inertia of the small stockholders was one of the most discouraging features of the whole reorganization.

of notes were funded into bonds, about $2,500,000, into stock, and less than a $1,500,000 [1] of floating bank debt was exchanged for the short term notes. Except for the willingness on the part of the merchandise creditors to exchange their open accounts for stock, no other feature helped the Company more than this funding of the floating debt. The following table shows the distribution of the new securities: —

FUNDING OLD OBLIGATIONS	NEW STOCK	NEW BONDS	NEW NOTES
Merchandise Creditors	$4,135,912		
Floating bank debt	2,500,000	$3,635,000	$1,474,650
CASH STOCK SUBSCRIPTIONS			
General Stockholders	2,404,550		
Security Investment Co. through its creditors	1,540,300		
George Westinghouse, through banks, as part of the Security Investment Co.'s subscription	1,502,775		
Employees	611,250		
	$12,694,787 [2]	$3,635,000	$1,474,650

From this short outline it is obvious that upwards of $12,000,000 of current accounts and floating debt were funded into stock and long term obligations. Over $6,000,000 of new cash was added. Two things were definitely accomplished, — the Company was furnished with a liberal fund of working capital, and the cloud of rapidly maturing obligations was changed into a stock liability, carrying no fixed charges. The relief to the Company can be clearly seen from a comparison of its debt and fixed charges before and after the consummation of the reorganization.

[1] $1,474,650; of these $98,750 were 15-year notes, the rest were 4, 5, and 6-year notes.

[2] These figures cannot be made to correspond exactly with the stock increase as shown by the balance sheet before and after reorganization. There were numerous charges and expenses incurred in effecting the reorganization. The table is, however, approximately correct.

BEFORE REORGANIZATION

	Debt	Interest
Funded debt (including Walker Co.)	$30,000,000	
Interest and sinking funds, about 6 %		$1,800,000
Floating interest bearing debt	9,210,000	
Interest approximately 6 %		552,000
Open accounts	5,242,000	
Upon which no trade discounts could be taken, say 6 %		302,500
	$44,452,000	$2,654,500

AFTER REORGANIZATION IN 1908

	Debt	Interest
Funded debt	$34,281,000	
Interest and sinking funds, about 5½ %		$1,925,000
Floating interest bearing debt (approx.)	1,700,000	
Interest approximately 5 %		85,000
Open accounts, upon which full trade discounts could be taken	1,000,000	
	$36,981,000	$2,010,000
From this should be taken the money furnished by the stockholders	6,059,000	
And the interest this additional capital would command		363,000
	$30,922,000	$1,647,000

The net debt of the Company was actually decreased from over $44,000,000 to less than $31,000,000, and the interest charges were cut from $2,650,000 to $1,650,000, — a decrease of $1,000,000 a year. Coincident with these changes in debt, the capital stock was increased from $29,000,000 to $41,000,000. A large debt, rapidly maturing, and carrying heavy charges, had been changed into a stock liability with no fixed charges. This, in brief, was the actual accomplishment of the Westinghouse Reorganization.

The magnitude and the simplicity of this reorganization deserve, however, more than passing notice. At the time of the appointment of the Receivers, the debt of the Company amounted to $43,000,000, and the total liabilities aggregated $83,000,000. In point of mere size, it was the most considerable mercantile failure America has ever witnessed. It quickened

and sharpened the crisis of 1907 more than any other single factor. From $82 a share in the winter, its stock fell to $16 a share at the announcement of the receivership. The failure of the Westinghouse Company, was in no sense due to the collapse of over-inflated values. Its assets cost a sum considerably greater than that represented by its liabilities other than stock, and they were worth more. But at a critical time, because of insufficient working capital, the impaired credit of its financial agent, and heavy charges necessitated by its accumulated floating debt, the Westinghouse Company became legally insolvent. The reorganization which followed this technical insolvency was of the simplest kind. It involved no sale of assets, no new company, not even any new form of security; no stock assessment was required, nor was a mortgage placed on the Company's property. The creditors merely funded their obligations, and the stockholders contributed additional money.

In spite of the long period which elapsed between them, it is perhaps impossible to find two industrial reorganizations which resulted from more nearly identical causes, and were consummated through more nearly identical measures than the Westinghouse reorganizations of 1891 and of 1908. Both followed crises in the Company's history, resulting directly from a too rapid investment of capital in fixed assets and indirectly from an unconservative business policy. At both times, the financial stability of the Company was wrecked through lack of working capital. The business was never an economic failure in the sense that it did not earn adequate interest and profits. On the contrary, the earnings were abnormally great and the dividend disbursements, in the periods immediately before, disproportionately high. The methods employed to secure relief were identical in the two cases also. A new stock issue was attempted exactly five months before the culmination of the difficulties in both instances, and the only persons who came forward in either case were Mr. Westinghouse and his immediate associates. In neither instance was the reorganization accomplished through the judicial sale of the property, and in neither instance was there an exchange of entirely new securities for the old or a new

funded debt created. The positive expedients were the same; the merchandise creditors and bankers funded their debts into stock, — in 1891, into preferred, in 1908, into common stock, — and new stock in considerable amounts was issued at par.

It is only fair to those who so successfully brought the Westinghouse Company through the crisis of 1907, to outline briefly the results of their policy. When the Receivers were discharged in the autumn of 1908, a new management assumed the control of the Company, for the merchandise creditors and the bankers had been unwilling to make the sacrifice which the reorganization involved, until they were assured that the errors in financial judgement and the recklessness in the declaration of dividends which had brought disaster to the Westinghouse Company were not to be repeated in the future. They took the management of the Company out of the hands of its former stockholders, and undertook to administer it themselves on the basis of a greater conservatism. A new Board of Directors was chosen, consisting of sixteen men who had been prominent during the receivership of the Company. Its members were selected from among the Bankers', the Merchandise Creditors', and the Stockholders' Committees, and their representatives. The financial policy was put in the hands of a committee of six. Edwin F. Atkins,[1] of Boston, represented the stockholders, and was subsequently chosen President; James S. Kuhn, of the Pittsburg First National Bank, represented the local bankers, and Albert H. Wiggin, of the Chase National Bank, the city bankers; Thomas W. Lamont, of J. P. Morgan & Company, represented the private bankers. Joseph W. Marsh, of the Standard Underground Cable Company, together with George M. Verrity, of the American Rolling Mill, represented the Merchandise Creditors.[2] The Directors chose Robert Mather, who presently became Chairman of the Board,

[1] To the wisdom of Mr. Atkins, to no small degree, was due the successful consummation of the reorganization and the subsequent rehabilitation of the Company. It will be remembered that Mr. Atkins has also shaped, more than anyone else, the financial policy of the American Sugar Refining Company since the deposition of the Havermeyer regime.

[2] Kuhn, Loeb & Co., who issued the convertible bonds in 1906, had no representation on the Board or Executive Committee. They had done next to nothing for the Westinghouse Company at the time of the crisis and reorganization.

to act for this Committee in the actual financial administration of the Company. The choice was a most fortunate one. Mr. Mather had no knowledge of electrical engineering, but had had rare financial experience as counsel for the Rock Island Railway. He came to the task, — no easy one because of the many conflicting interests, — without prejudices, but in hearty sympathy with the conservatism desired by the new management. He showed a far sighted wisdom in the direction of the Company's affairs, and at the time of his death, the financial condition of the Westinghouse Company was rapidly assuming a secure position. The brief experience of Mr. Mather in the Westinghouse management showed clearly that his death was a real calamity to the Company, and a serious loss to the business world.

But the rehabilitation of the Westinghouse Company was not secured immediately. The year ending March 31, 1909, — the first full year after the failure, — was the poorest ever experienced by the Company. Not even in the early nineties, when the Westinghouse Company was a small local concern, were the earnings so meagre and discouraging. Two years before, the sales had amounted to $33,000,000, in the year 1908–09, they amounted to $20,000,000. In the former year the profits from sales of merchandise were over $4,000,000, in the latter year hardly $500,000. The year ending in the spring of 1907 gave a surplus of nearly $3,000,000, that ending at the same time in 1909, a deficit of almost exactly the same amount. There was a difference of profit and loss of the two years of nearly $6,000,000. A liberal amount of this, nearly $2,000,000, resulted from charging off patent accounts, foreign investments and fictitious assets. This was a part of the conservatism of the new management. Yet in spite of this adjustment, the unfortunate year of 1908–09 shows clearly the ill effects on the trade of the Company of its embarrassment and of the general depression following the panic.[1] Since

[1] The contrast in earnings with the General Electric Co. is striking:

	General Electric Year ending Jan. 31st	Westinghouse Year ending Mar. 31st
Gross sales, 1907	$60,071,883	$33,026,240
Manufacturing profits	6,965,289	4,179,575
Gross sales, 1909	44,540,675	20,606,592
Manufacturing profits	2,891,102	650,784
Percentage of decline in sales	25.80%	37.6%
Percentage of decline in profits	58 %	84.4%

the spring of 1909, the business of the Company has regained its former proportions. In the year ending March 31, 1910, there were net earnings of $3,500,000, and other income of another $1,500,000. During the following year, the sales rose to $38,-000,000, — the largest in the Company's history, — and the total income to over $7,000,000. No dividends were, however, declared on the common stock, and the management charged off over $4,000,000 to depreciation of plant and investments.[1] The next two years were equally encouraging and as this history is in process of construction, the common stock has been placed on a dividend paying basis after the building up of a liberal margin of surplus.

[1] This annual report of March 31, 1911, is worthy of permanent preservation for its fulness, frankness, and the willingness of Mr. Mather to express opinions of the " worth " of inventoried investments. It was his last report and shows clearly the foundation of a policy, the good results of which were just beginning to bear fruit. In its detailed completeness, the present writer knows not its equal among corporation reports. He has used it in his classes in " Corporation Finance " and in " Accounting " as a model of the kind.

APPENDIX

(Referred to on p. 171.)

STATEMENT OF DISTRIBUTION OF STOCK OF WESTINGHOUSE ELECTRIC & MANUFACTURING COMPANY

After Reorganization	Shares
Shares authorized	200,000
Deduct total shares outstanding	145,378
Leaving unissued	54,622
Deposited with Trust Company	138,464
Deduct to be issued to depositors (Assenting)	83,078.40
Leaving unissued	55,385.60
Non-assenting stock	6,914
Deduct from " Assenting " stock to be issued to depositors	83,078.40
60 % of 9,770 shares of collateral stock	5,852
Leaving actually outstanding after paying loans	77,216.40 (*)
Deduct from surrendered stock	55,385.60
For Preferred Stock	20,000
Leaving as " Assenting " stock	35,385.60
Add to stock now unissued	54,622
Collateral stock coming in (60 % of 9,770 shares)	5,862
Leaving available	60,484
Deduct for Preferred issue	60,000
Leaving for " Assenting " stock	484
Add Preferred stock from Treasury	60,000
Add Preferred stock from stockholders	20,000
Gives total Preferred stock authorized	80,000.00
Add " Assenting " stock from Treasury	484
Add " Assenting " stock from stockholders	35,385.60
Gives total " Assenting " stock available	35,869.60
Non-assenting stock, as above	6,914

Funds to Draw from:		
Preferred stock		80,000
"Assenting" stock		35,869.60
Preferred Issue:		80,000
Sell	60,000	
U. S. stock deposited	3,199.50	
U. S. stock to complete	805.50	
Consolidated stock deposited	3,857.06	
Consolidated stock to complete	2,481.44	
Commissions	2,500	72,843.50
Leaving available		7,156.50
Assenting Issue:		35,869.60
U. S. stock deposited	6,388	
U. S. stock to complete	1,601	
Consolidated stock deposited	7,714.12	
Consolidated stock to complete	4,962.88	
George Westinghouse, Jr.	2,000	22,677 (*)
		13,192.60
Preferred issue	7,156.50	
"Assenting" issue	13,192.60	
	20,349.10	

Verification

Non-assenting stock	6,914	
60 % Assenting outstanding	77,216.40	4,148.40
Preferred outstanding	72,843.50	
Preferred in	7,156.50	
Assenting outstanding	22,677	
Assenting in	13,192.60	2,765.60
	200,000	

Note. There were two arithmetical errors in the original memorandum which are retained here (marked *).

CHAPTER VIII

The National Salt Company

Peculiar competitive conditions in the salt industry, 204; the National Salt Company of West Virginia, 205; the formation of the National Salt Company of New Jersey, 206; proportionate control of the National Salt Company, 208; early extensions of control, 209; purchase of the United Salt Company of Ohio, 210; effect of control on the price of salt, 212; early financial success, 213; promotion of International Salt Company, 215; extension of the International Salt Company, 220; litigation with the United Salt Company, 222; distress of the National Salt Company due to over-production, 225; sale of the New York plants of the National Salt Company, 225.

Chronological Summary

1866. First agreement among salt producers.
1888. Selling association in the New York field.
1899. Promotion of National Salt Company of New Jersey.
1900. Company becomes dominant in the New York, Michigan, Ohio, Kansas, and Texas fields.
1901. Promotion of International Salt Company.
1902. Receivership of the National Salt Company.
1903. First sale of National Salt Company's New York plants.
1904. Final sale of National Salt Company's New York plants.

The combination of salt producing companies was an example of an attempt to create a monopolistic control over one of the cheap necessities of life where a monopoly of the opportunities of production was impossible. Originally our supplies of salt were obtained from the evaporation of ocean brine, but this method of production is now but little used in the United States. Practically all the salt consumed in this country, except a small amount imported from the south of Europe, is obtained from large subterranean deposits of salt, existing in certain localities. These deposits are operated according to two methods. The simplest is that of mining the salt in a way that resembles the mining of coal. Mined salt, or rock salt, is never very pure. By far the largest amount of salt used in the United States

is obtained by sinking double tubes or wells into the deposits and the artificial evaporation of the brine pumped up through these wells. The industry is located chiefly in the Central New York region of New York and the Saginaw Valley of Michigan, although considerable quantities are produced in Ohio and Kansas.

Certain conditions of the manufacture and distribution of salt favor competition; certain conditions do not. Unlike most extracted commodities, the original cost of the raw material is almost negligible as anyone is free to acquire land upon which a salt well may be sunk. In New York the salt land area is some two hundred miles in length by thirty or more in width. The only expenses required are in the sinking the wells and the construction of a plant for the purification and evaporation of the brine. This was not large in the period to which this narrative relates, so that when a well was once sunk the actual cost of producing the salt was very largely represented by the interest on the invested capital. Not unlike a railroad, it was nearly as economical to continue to manufacture at a loss as to shut down the plant. This was especially true in the Michigan field where waste sawdust and slabs were used for fuel. Under these conditions the manufacturers there continued to produce, whatever the conditions of the market, so long as the price received for the salt paid for labor. They invaded territory contiguous to other salt fields, and they felt the competition of other fields in markets naturally their own. Conditions of most drastic competition naturally resulted. One thing, however, always acted as somewhat of a check. Salt is a very cheap commodity. The producer sometimes obtains no more than forty cents for a barrel weighing two hundred and eighty pounds. So that in places five hundred or a thousand miles from the salt fields the freight amounted to more than the original cost of the salt. For this reason there were natural geographical limits, beyond which the salt of any one field could not be sold for a price that would reimburse the manufacturer for the cost of the product.

The first notable consolidation of salt manufacturers occurred in the Michigan field about 1866, and a definite pooling associa-

tion was formed April 16, 1868.[1] The pool was, on the whole, successful, and did not seek to exact monopolistic prices. Yet the limitations of freight rates gave the pool little influence on markets east of Buffalo, where the situation was controlled by the New York manufacturers, among whom competition of the severest character existed. In the years beginning about 1885 few of the New York salt wells were conducted at a profit. It could be said that no manufacturer was able to conduct his business with any margin of profit, unless he owned exceptional facilities for the economical handling of coal and salt, or enjoyed especially favorable terms in the purchase of coal. About 1898 Archibald S. White[2] conceived the idea of forming a selling association which should take the salt from the various New York wells and dispose of it to the best advantage for all. Accordingly, the National Salt Company of West Virginia was formed. The underlying motive of the Association was undoubtedly that of controlling the selling price of salt by controlling the production of the New York wells. The ostensible motive upon which the Association sought to appeal to the jobbing and packing trades was to bring about car-lot loading and the more economical handling of salt. Although the Association had a nominal existence for a number of years it was not a success. The deep-seated jealousies of the manufacturers, sometimes based on nothing more substantial than religious differences, created constant friction. The prices of salt and the conditions of its sale remained, on the whole, fully as competitive under the Association as before.

Competition of the New York manufacturers was exceedingly keen during the period from 1894 to 1899. The geographical position of their wells gave them a strategic advantage over all

[1] A full and detailed account down to 1888 of the Michigan association is given by J. W. Jenks in III *Q. J. E.* 78. Reprinted *Trusts, Pools, and Corporations*, edited by Wm. Z. Ripley, Chapter I.

[2] White had been an employee for one Moulton, a salt dealer. He became the Boston representative of the Bradley Salt Company and subsequently, with others, formed the Cayuga Lake Salt Company. He was the central figure in the consolidation movement down to the formation of the International Salt Company in the autumn of 1901.

other manufacturers in the eastern markets, but they were restrained from exacting monopolistic prices by the competition of foreign salts, imported largely as ship ballast. The competition among the producers themselves had driven the price of salt on the eastern markets almost below the cost of production. Under these circumstances the owners of the wells were very ready to listen to the advice of Mr. White that they enlarge the scope of the National Salt Company so that it might obtain actual control over the amount of production and the price policy. To accomplish this end the National Salt Company of New Jersey was formed, which, in course of time, acquired absolute title to the salt plants.

Plans for the consolidation of New York wells were under consideration as early as the autumn of 1898. By March 4, 1899 the *Chronicle* announced that arrangements were pending to unite the companies manufacturing some 90% of the product of the New York fields.[1] Two weeks later the National Salt Company was incorporated in New Jersey with an authorized capitalization of $12,000,000, of which $5,000,000 was 7% preferred stock and $7,000,000 was common stock. Of this amount $2,400,000 of preferred stock, and $3,500,000 of common stock were issued to acquire twelve plants,[2] and $450,000 in money. Each owner was paid for the tangible value of his plant in preferred stock, on the basis of a valuation made by the other owners. It was stated at the time that the common stock was given to the owners of the wells to an amount equal to five times the average yearly net profits of the preceding two years.[3] Some of the manufacturers chose to take money instead of securities for their works and in that case surrendered one share of the preferred and one share of the common stock received in the original allotment for each $100 demanded in money. The requisite amount of money and the working capital were obtained through a subscription managed by the Atlantic Trust

[1] 68 *Chron.* 429.

[2] The National Salt Company acquired thirteen plants, but soon resold one, the Leroy.

[3] XIII *R. I. C.* 249.

Company. The subscribers received one share of preferred stock and one of common stock for $100 contributed.[1] $1,150,000 was obtained in this way. The allotment was largely oversubscribed and the original subscriptions were cut down about one-half. During the first two years of the Company's existence the market price of one share of the preferred and common stock together was in excess of $100.

Taking into account the working capital obtained from the public subscription the National Salt Company surrendered $1,950,000 in preferred stock and $3,050,000 in common stock for the plants and businesses of the twelve[2] New York Salt Companies, having a capacity of about 6,150 barrels of fine salt per day.[3] It was well known at the time and clearly recognized by the public and those directly concerned that the preferred stock was issued for actual, tangible property at a fair market valuation. A very careful estimate made of the tangible property acquired by the National Salt Company placed its value

[1] Subscription agreement dated March 6, 1899, reproduced XIII *R. I. C.* 251 outlined in 68 *Chron.* 524.

[2]

Plant	Location (all N. Y. State)	Production	Approximate Daily Capacity (barrels of 280 lbs.)	Probable Value
Glen	Watkins	Grainer and Refined	800	$325,000*
Cayuga Lake	Ludlowville	Refined	750	250,000
Kerr	Rock Glen	Grainer and Refined	700	140,000
Bradley	Warsaw	Refined	500	150,000
Ithaca	Ithaca	Grainer	600	125,000
Warsaw	Warsaw	Grainer	500	100,000
Empire Dairy	Warsaw	Refined	600†	150,000
W. C. Gouinlock	Warsaw	Grainer	500†	60,000
Hawley	Warsaw	Grainer	500†	60,000
Pavilion	Pavilion	Grainer	200†	30,000
Pearl	Pearl Creek	Grainer	300†	40,000
Silver Lake	Perry	Grainer	200†	30,000
			6,150	$1,460,000

Grainer salt is coarse salt obtained by evaporation in open pans.

[3] It was stated in the public announcements that the plants acquired by the National Salt Company had a capacity of 10,400 barrels. This was repeated in the testimony before the Industrial Commission (XIII *R. I. C.* 249 f.). This estimate was a gross exaggeration. Of the operating capacity of 6,150 barrels, at least 2,000 could not be operated profitably.

* The Glen works were distinctly the best in the consolidation. They had dock facilities, costing and worth upwards of $25,000, which aided much in the economical handling of coal and salt. The plant had a "single effect vacuum pan" system costing considerable to install.

† The last six plants produced grainer salt in open pans. Plants discontinued within one and a half years. Operation too expensive.

at $1,460,000. The common stock was issued in the belief that the total earning capacity of the separate plants had been about $600,000.[1] This estimate was obviously too high as the prospectus states that the earnings were "not less than $450,000" and that "By the proposed union, economies in the manufacture, transportation, and distribution of the product, it is estimated, will amount to not less than $150,000 per annum."[2] We are, therefore, approximately right in saying that the National Salt Company acquired plants and working capital worth about $2,000,000, in exchange for $2,400,000 preferred stock and $3,500,000 of common. The public subscribers, who acquired the stock on a subscription basis, paid at the rate of $2,400,000 for tangible property worth about $2,000,000, without any consideration for earning capacity and good-will. It would seem that the promotion had been conducted along most conservative lines.[3] The market price of the Company, using the early market quotations of its securities as the basis of the estimate, was approximately $2,275,000.

In the public announcements of the formation of the National Salt Company, it was stated that the Company would control 90% of the output of the New York fields. This was an overestimate. As previously stated the maximum capacity of the wells was 6,150 barrels a day and the efficient remunerative capacity was not more than 4,000 barrels. The Worcester Salt Company and the Watkins Salt Company, the two largest producers of salt in the New York field, were not included.[4] The former had a capacity of 1,500 barrels. It had expended large

[1] $3,000,000 common stock issued for five times average net earnings during the two preceding years. (XIII *R. I. C.* 249.)

[2] Plan of organization dated March 11, 1899. Reproduced XIII *Chron.* 250. Outline in 68 *Chron.* 524.

[3] According to the evidence of the officers, no stock was issued as promoters' profits. The Atlantic Trust Company, which managed the cash underwriting, was paid $5,750, which was charged to organization expenses. XIII *R. I. C.* 250.

[4] Negotiations were under way for the purchase of the Worcester Salt Company at the time of the formation of the National Salt Company. A price of $1,000,000 was demanded. This was, proportionately, far more than the price paid for any of the other plants. A. S. White was advised to purchase the plant for the National Salt Company. He refused because of the excessive price.

sums in establishing its trade-mark, and such was the domestic demand that the retail grocers were willing to pay double for Worcester Salt what was asked for other salts prepared for household consumption. The Watkins Salt Company had a modern plant with the most efficient equipment. Its maximum capacity was 2,000 barrels. Smaller wells, — the Remington and others, — would bring the competitive production close to 5,800 barrels a day. It would appear that the National Salt Company controlled in 1899 about 52% of the total capacity (12,000 barrels a day) of the New York wells. If the plants having a high operating efficiency were alone considered, the percentage would be approximately the same.[1]

The corporation was under the control of the salt manufacturers. The President, A. S. White, was prominent in the Cayuga Lake Company and President of the old West Virginia Company and had been responsible more than anyone else for the formation of the consolidation. At least seven of the original thirteen directors were practical salt manufacturers, chosen from among the men prominent in the constituent companies. The corporation started upon its career remarkably free from manipulative influences. But this conservatism did not last long. Its avowed purpose, as expressed in the original prospectus, was to control "the product of other salt companies in the states of Ohio and Michigan."[2] No sooner was the Company organized than it began to carry out its design of extension. It strengthened its position in New York State by acquiring another plant and by entering into an agreement with its largest competitive producer to market its salt at a relatively high price.

[1] Various rough estimates of the actual control of the National Salt Company over the New York production have been made for the writer by men familiar with the salt business. "They never succeeded in controlling 50% of the production in New York State" represented one extreme, and "probably 80 or 90 per cent" the other. The above estimate of 52% was probably near the truth. It would vary somewhat according to the seasonal demands in the fish packing industry, the price of coal and the conditions in the Michigan field which led those producers to either retire from or become active in the eastern markets. As the price of salt would rise, the less economical plants could be pressed into service.

[2] Plan of organization dated March 11, 1899. Reproduced in XIII *R. I. C.* 250. Outlined in 68 *Chron.* 524.

It purchased two and leased three plants in Michigan and entered into a contract with the Michigan Salt Association for the marketing of the product of the Association; Walter S. Eddy, President of the Michigan Salt Association entered the National Company's Board of Directors. It purchased the entire stock of the Hutchinson Kansas Salt Company which owned, subject to a small mortgage,[1] ten salt plants producing upwards of three-quarters of the Kansas output. It purchased about two-thirds [2] of the stock of the Lone Star Salt Company that then controlled a large part of the Texas evaporated salt. The Company also entered the foreign field, and caused to be incorporated the Spanish American Salt Company, — April 4, 1900, — which acquired the business of the Salinera-Espanola Company that controlled the sale of evaporated salt made in Spain and Italy. The Spanish salt was largely used in the fish curing industry in Newfoundland, British Columbia, and Argentina.

Perhaps that part of its policy of extension which proved of the most far-reaching consequence to the National Salt Company was the acquisition of the United Salt Company of Ohio, then dominating the Ohio field, by an exchange of its own stock for that of the Ohio Company with a guarantee of high dividends for five years.[3] The contract is worthy of careful consideration, and can best be explained from a quotation, taken bodily from the original option. "For each share of stock in the United Salt Company purchased from the undersigned (the stockholders of the United Salt Company) there shall be given 1.25 shares of the 7% preferred stock and 1.25 shares of the common stock of said National Salt Company, and in addition thereto said company shall pay for each share of the stock of the United Salt Company the sum of $106.25 in cash, payable in ten equal semi-annual instalments on the 1st days of January and July of each

[1] $300,000 maturing January 1, 1912. 1900, N. S. Co. Rep. 6.

[2] 1,326 shares out of total 1,950 shares.

[3] The United Salt Company of Ohio was supposed to be under the influence of the Standard Oil Company of Ohio. F. B. Squire of the latter entered the directorate of the National Salt Company soon after the United Salt Company was acquired. The United Salt Company owned three plants at Cleveland one at Akron, and leased four plants in Meigs County, Ohio. Stock Exchange Application, Unlisted Department, dated September 13, 1900.

year, beginning with Jan. 1st, 1900."[1] In brief this agreement involved the purchase of the 9,934 shares of United Salt Company on the basis of five shares of National Salt Company's common and preferred stocks for four shares of the United Salt Company, and in addition the former corporation guaranteed semi-annual dividends of $10.62 for five years on those shares of its own stocks given in exchange. This was 7% on the preferred stock and 10% on the common stock.[2] Certificates of indebtedness, issued by the American Trust Company of Cleveland, were given in exchange for the United Salt Company's stock. They obligated the National Salt Company to pay 21% a year on the stock of the United Salt Company, — $1,055,-487.50 during the five years, on stock of a par value of $993,400. It is doubtful if the United Salt Company's stock was worth more than its par value.

Through these various transactions the issued capitalization of the National Salt Company increased from $5,900,000 to $11,-806,250. Controlling, as it did at first, about 52% of the New York production or 17% of the country's output of evaporated salt, without any influence outside of New York State, it gradually extended its control until by the middle of 1900 it had the nominal control at least of the New York, Michigan, Ohio, Kansas, and Texas fields.[3] It was marketing about 73% of the evaporated salt produced east of the Rockies, or about 67% of the total of the evaporated salt of the country.[4] President

[1] Agreement of United Salt Co. stockholders and National Salt Co. dated Cleveland, Ohio, July 20, 1899, paragraph 2.

[2] This was directly stated by the National Salt Company. "This agreement of July 20, 1899, contemplated the payment semi-annually, for a period of five years, of a sum of money which would be the equivalent of seven per cent per annum on preferred and ten per cent per annum on common stock of National Salt Company. . . ." Stock Exchange Application, Unlisted Department, National Salt Company, No. 2, Supplemental Statement.

[3] The following is taken from the special Census Report of Manufactures for 1905. Part III, page 517.

Proportional production in different states for 1900:

N. Y., 32.2%; Mich., 34.3%; Kansas, 10.8%; Ohio, 9.6%; Utah, 1.5%; Cal. 4.2%; Tex., 2.1%; W. Va., 1.5%; other states, 3.7%.

[4] President White gave the estimate as 85 to 90% of the control east of the Rockies. (XIII *R. I. C.* 249.) He stated it as "more than ninety per cent"

White estimated that the Company was marketing upwards of ten million barrels of salt during 1900, of which 4,850,000 barrels were produced at plants owned by the Company and 5,150,000 barrels were purchased.[1] A very large part of the salt purchases, certainly nearly four million barrels, came from the wells of the members of the Michigan Salt Association.[2] From these facts it is obvious that the management of the National Salt Company contemplated a monopolistic control of the salt market of the country and appeared to be rapidly attaining its goal.

This purpose was further indicated by the Company's price policy. There seems no doubt but that prices of salt increased some 20% from 1899 to 1900, and about 16⅔% from 1900 to 1901.[3] Viewing the matter broadly, the net price of salt at the point of production was between 40 and 50% higher two years after the National Salt Company came into existence than it

in the stock exchange application. (Unlisted, dated September 13, 1900.) These estimates are rather high as the Michigan Salt Association, which marketed through the National Salt Company and the Company's own five Michigan plants controlled only from 70 to 80% of the Michigan output. The Company had about the same proportional control in Kansas, Ohio, and Texas. The most exaggerated estimate was the report (probably inspired) published in the *Commercial and Financial Chronicle* that the Company's control was "equal to about 95% of the country's output." 69 *Chron.* 853.

[1] Report to New York Stock Exchange, Unlisted Department, dated September 13, 1900.

[2] Indirect evidence of this in statement to *Commercial and Financial Chronicle* at the time the Michigan plants were acquired. (69 *Chron.* 853.) Stated to be true by an excellent authority.

[3] The prices of salt must be estimated in terms of net prices at the salt wells, as prices at points of consumption are made up largely of freight charges. The following figures represent the Michigan Salt Association average annual prices per barrel of 280 pounds of fine salt, f. o. b. Saginaw. During 1900 and 1901, prices elsewhere corresponded closely with the Michigan prices, so that the increase there was typical of the increase elsewhere in the country. Records of the Association. The 1901 price was an estimate by President White of the National Salt Company in testimony before the Industrial Commission. XIII *R. I. C.* 254.

Year	Price per barrel	Year	Price per barrel
1893	$0.44 7/10	1898	$0.43 8/10
1894	.51	1899	.38 4/5
1895	.48 9/10	1900	.47
1896	.40 1/8	1901 (about)	.55
1897	.41		

was at the time of its organization. One especial condition favored the Company's price policy. The demand for salt is inelastic. In the kitchen or the packing house the cost of the salt is so low, comparatively, that a rise of fifty or more per cent in the price has no effect upon the demand. People use quite as much salt when the price is high as when it is low. The Company did exactly the same thing that the National Cordage Company sought to do, some twenty years before; it tried to fix the price of a stable commodity produced nominally under conditions of free competition, by a control of the country's sources of supply. The Company increased its actual ownership of plants throughout the country and bought, at excessive prices, the output of competitive manufacturers. By exactly the same means did the National Cordage Company seek to accomplish the same end.

The first year of the Salt Company's business was successful financially. As early as July, 1899, the officers reported to the *Commercial and Financial Chronicle* that "the report of operations from April 15 to July 1, 1899 showed earnings at the rate of 7% per annum on the preferred stock and over 10% on the common."[1] After paying the regular dividends on the preferred stock for the first nine months, the Company showed an item of $303,144.88 carried to the surplus account of January 1, 1900.[2] This was at the rate of $605,800 a year. At the time of promotion it was stated that the earnings of the constituent wells were in excess of $450,000 a year, and that the economies of consolidation would add at least $150,000 more. This experience of the National Salt Company is possibly unique in the histories of our industrial consolidations, in the fact that the earnings of the first year were identical with the prophesied earnings at the time of promotion. By July 31, 1900, the Company had accumulated a surplus of $654,664.56 after payment of its regular 7% dividends on the preferred stock, and 6% on the common stock, and after having met the regular instalments on its certificates of indebtedness carried in behalf of the United

[1] 69 *Chron.* 230, July 29, 1899.
[2] 1900 N. S. Co. Rep. 8. Reproduced XIII *R. I. C.* 259.

Salt Company's stock. By January 1, 1901 the surplus had increased to $778,949.32,[1] after over $200,000 had been deducted on account of depreciation and the regular charges had been fully met. During this time the preferred and common stocks of the Company were quoted regularly on the New York Stock Exchange. Their prices were relatively high and without considerable fluctuations.[2] By all these signs the Company was extremely successful.

Its difficulties, however, lay in two directions. They were not easily recognized, but were cumulative in their effect. The Company was staggering under the burden of the contracts entered into in order to obtain its wide-spread control of the market, and this control was slipping away from it as new competitors sprung up on every side. Like the National Cordage Company, the National Salt Company sought to maintain excessive prices by purchasing the plants and the products of its competitors. The task was too great. At first successful, its very success stimulated competition. Like the cordage monopoly, maintained by manipulation, the salt monopoly fell to pieces almost the moment competition made itself felt. The condition was clearly and succinctly expressed by Mortimer F. Fuller, later President of the reorganized consolidation, in speaking of the condition of the National Salt Company in 1901, hardly six months after the publication of its very favorable report covering the business of 1900: — "Certain unwise trade agreements were in force between the National Salt Company and various independent salt producers. These agreements stimulated a large over-production of evaporated salt, which in turn caused a serious decline in prices, and eventually resulted in the bankruptcy of the National Salt Company in 1902." [3]

The apparent success of the National Salt Company attracted

[1] 1900 N. S. Co. Rep. 8. Reproduced XIII *R. I. C.* 259.

[2] April, 1899. Beginning of the Company, preferred, 78; common, 40.
1899. Preferred, low, June, 73; high, July, 79.
Common, low, April, 40; high, June, 49.
1900. Preferred, low, August, 63; high, March, 78.
Common, low, September, 39; high, April, 48.

[3] 1910 I. S. Co. Rep. 6.

the attention of E. L. Fuller, then prominent in the mining or rock salt branch of the industry.[1] He had obtained control of a combination of four salt mines, known as the Retsof Mining Company, and he wished to extend the operations of the Company into the field of manufactured salt from brine. Meanwhile A. S. White, being confident of at least the temporary success of the National Salt Company, had gradually sold his preferred stock and purchased the common stock at much lower prices until he had acquired a considerable block of the common stock. At this point E. L. Fuller offered to buy this common stock at a good deal higher price than that paid for it, provided White agreed to retire from the salt business after Fuller had brought about a union of the Retsof and National Companies.

The capitalization of the Retsof Mining Company consisted of $2,500,000 in 5% bonds and $3,600,000 in stock upon which 4% had been paid. To acquire these securities, as well as those of the National Salt Company, E. L. Fuller caused to be incorporated, August 22, 1901, the International Salt Company of Jersey. The plan of incorporation explicitly stated it to be the intention of the new Company to acquire a majority of the stocks of the Retsof and National Companies — "properties or securities of Canadian salt companies, some minor salt plants in the United States, the salt companies of Porto Rico, and the salt industries of Great Britain." [2] It appears that E. L. Fuller had become impressed with the success with which the Standard Oil Company had gradually obtained a world control of the petroleum industry and he wished, apparently, to achieve the same result in the salt industry.

The International Salt Company had an authorized capitalization of $30,000,000 in stock and $12,000,000 in bonds, all of

[1] Fuller had been a coal dealer. He controlled a salt mine known as the Lehigh. Its product was of inferior quality. In the vicinity was the Livonia mine, the product of which was considered excellent. Fuller made arrangements with certain wealthy stockholders of the Livonia mine to unite the two companies. Subsequently the Retsof and the adjoining Greigsville mine were taken into the combination and the name was changed to the Retsof Mining Company. Fuller was the President of the Company. The name of the Retsof mine was derived from that of its founder, one Foster, spelled backward.

[2] Plan of organization, I. S. Co., dated September 18, 1901, p. 3.

which was to be used to acquire, through exchange, the stocks and bonds of salt companies in this country and abroad. In order to be sure of first securing control of the National and the Retsof Companies the officers entered into an agreement with a syndicate managed by Oakleigh Thorne to secure the exchange of a majority of the National and the Retsof Companies' stocks and to furnish at least $1,000,000 in working capital. This syndicate agreement has become somewhat notorious in financial history, owing to the fact that the syndicate members received, as commission, apprcximately one-third of the issued stock of the new company. Ostensibly under date of September 14th, the International Salt Company, organized three weeks before, sent a letter to the Board of Directors of the National Salt Company offering to give $1,000 in International Collateral Trust 5% bonds and $100 in the new International Company's stock in exchange for every ten shares of National Company's preferred stock. In the same proposal the syndicate offered to give one share of International stock for every share of common stock. Copies of the letter were transmitted to the National Salt Company's stockholders with the recommendation of the Board of Directors, signed by the President, that the offer be accepted.[1] A similar proposal was made to the bond and stockholders of the Retsof Mining Company by which the syndicate offered to acquire the bonds on the same basis that they acquired the National Company's preferred stock and the single class of Retsof stock on the same basis as that of the National Company's common stock.

There were outstanding such securities of the National and Retsof Companies that approximately $7,500,000 in the bonds and $11,156,250 in stock of the International Company would be used in the exchange, provided the new company secured all the outstanding stocks of the old companies. The Thorne syndicate received $7,500,000 in bonds and $18,750,000 in stock. The balance of over $7,000,000 in stock was to go to the syndicate, in payment for commission "defraying organization

[1] Letter from National Salt Company to its stockholders dated September 28, 1901. Outline of whole plan in 73 *Chron.* 724.

expenses and furnishing a cash working capital for the International Company to the extent of at least $1,000,000."[1] The International Salt Company, being only a holding company, had little use for "working capital," unless it was to make advances to its subsidiaries which the stockholders were given to understand were well fortified with liberal surpluses. At all events no accounting was made by the International Salt Company to its stockholders of any money received directly from the Thorne syndicate. The terms of exchange may be seen from the table given on the next page.

From this table it is clear that the outstanding securities were increased from over $18,000,000 to over $26,000,000. The fixed charges on bonds increased from $125,000 to $375,000 although the fixed and contingent charges ahead of the common stock decreased from $475,000 to $375,000. A reduction of charges was the chief argument used to persuade the National stockholders to exchange their securities, but it could hardly be regarded as real if accomplished by tripling the fixed charges. And the National Company's preferred stockholders could well take the position that the new International Company's bonds were even less desirable than their own stock, that being a first lien of smaller size upon what appeared to be the most valuable of the International Company's assets. Many of them believed that either they were being led into a disadvantageous exchange or else were being deceived regarding the true conditions of their Company's affairs. As things developed the exchange may be considered as highly advantageous to them considering the difficulties that confronted the National Salt Company.

The reorganization resembled others, — such as that of the National Starch Manufacturing and the Glucose Sugar Refining Companies, — in which the primal motive was to extend the control over a wider field of the industry. In all these cases the total par value of the outstanding securities was increased and the charges decreased only slightly if at all. The motive of such reorganizations was extension of control rather than financial rehabilitation and no need seemed apparent for reducing the

[1] Plan of Organization, I. S. Co., p. 2.

REORGANIZATION OF THE INTERNATIONAL SALT COMPANY

	Old Company's Securities given in Exchange					New Company's Securities		
	Bonds	Fixed Charges	Preferred Stock	Contingent Charges	Common Stock	Bonds	Fixed Charges	Stock
National Salt Company:								
Preferred Stock (29,725 shares in Treasury) ...	....	....	$5,000,000	$350,000	....	$5,000,000	$250,000	$500,000
Common Stock (164,025 shares in Treasury)...	....	...	...	....	$7,000,000	....	....	7,000,000
Retsof Mining Company:								
Bonds	$2,500,000	$125,000	....	....	....	2,500,000	125,000	250,000
Stock	...	....	.	...	3,600,000	....	...	3,600,000
Promoter's Commission	....	....	...	...	..	..	. .	7,400,000
Totals	$2,500,000	$125,000	$5,000,000	$350,000	$10,600,000	$7,500,000	$375,000	$18,750,000

SUMMARY	Old	New	Change Amount	Change Percentage New to Old
Securities bearing Interest	$2,500,000	$7,500,000	+$5,000,000	300%
Securities bearing Interest and Contingent Charges	7,500,000	7,500,000	....	100%
Total Securities	18,100,000	26,250,000	+ 8,150,000	145%
Fixed Charges	125,000	375,000	+ 250,000	300%
Fixed and Contingent Charges	475,000	375,000	− 100,000	79%

capital liabilities or the fixed charges. The larger share of the market anticipated for the reorganized combination seemed a substantial basis upon which to expect larger profits.

In less than a month after the circular letter was sent out offering the exchange to the National Company's stockholders, a majority of the stock had been deposited. From reference to the stock exchange transactions it would appear that a relatively small volume of the stocks were traded in, so that fully a majority must have been held by the men close to the management.[1] From subsequent reports it seems that the International Company acquired through the syndicate agreement $2,970,900 out of a total issue of $5,000,000 preferred stock, and $4,351,200 out of a total issue of $7,000,000 of the National Company's common stock. This amounted in all to five-eighths of the outstanding capitalization. The International Salt Company also secured $2,367,900 out of $3,600,000 of the Retsof stock, or approximately two-thirds of the issue.[2] The new consolidation therefore began with a liberal working control of the National and Retsof Companies.

A minority of the stockholders of the National Salt Company had refused to accept the terms of consolidation offered by the International Salt Company and entered into negotiation with E. L. Fuller in order to secure more liberal terms. Much of this minority stock was then held by parties who had acquired it on the eve of the reorganization, and who hoped to obtain a profit by refusing to exchange their securities, and, by retarding the reorganization, compel the management of the International Salt Company to purchase their shares at an advance.[3] No

[1] President White testified before that from 20 to 30% of the stock was represented by the Directors. XIII *R. I. C.* 264. There is every reason to suppose that the Directors actually controlled more than this.

[2] 1910 I. S. Co. Rep. 4. Subsequently the International Company purchased for $2,299,200 in stock and $161,220 in cash, $1,221,100 out of the remaining $1,232,100 stock of the Retsof Company. *Ibid.*, p. 6. The terms of this transaction were at least twice as favorable to the minority interest as those offered in the original plan of exchange.

[3] The Wall Street district was discussing at the time the very large profits secured by certain speculators who had bought up a minority interest in a prominent industrial corporation about to be absorbed by another, and had exacted onerous

settlement was effected. In February, 1902, a protective committee was formed from among these minority preferred stockholders of the National Salt Company. It asked for deposits of stock and the payment of fifty cents a share to enable the committee to protect the minority interest.[1]

Proceeding to carry out the purpose for which it was formed, the International Salt Company acquired, early in 1902, the entire stock of the International Salt Company of Illinois, a distributing company for the products of the National and Retsof Companies. The price paid for the Company's $1,000,000 of stock was $1,330,000 in bonds, together with some money. From subsequent operations of this Company it is absolutely clear that it was not worth anywhere near as much as the par value of the bonds given in exchange.[2] The International Salt Company acquired, too, in 1903, the Port Huron Salt Company, a producing company owning four small wells near Port Huron, Michigan, and a three mile branch railway. For this piece of property the International paid $200,000 in bonds.[3] These represented the extensions of the International Salt Company. The intended control of the salt industries of Porto Rico and Great Britain never materialized. In the meantime the storm, for some months gathering around the National Salt Company, began to assume threatening proportions.

The National Salt Company was no longer able to maintain monopolistic prices of salt, due to over-production and the increase of competition. During the calendar year of 1900 the Company paid 7% on the preferred stock, 6% on the common stock, and, after liberal charges to depreciation, had shown an

terms from the majority interest. Several times already in these studies it has been noted that a minority interest, usually acquired by speculators, has sought to impede or prevent a reorganization in order to take advantage of a corporation's predicament and drive as hard a bargain as possible.

[1] Agreement, Henry K. Pomroy, H. Arthur Pomroy, George F. Dominick, Jr., Committee; Chas. T. Terry, Counsel; N. Y. Security & Trust Company, Depository. P. 1.

[2] See summary of operations of the western group, of which this was the most important distributing agent in 1910. I. S. Co. Rep. 9.

[3] 1910 I. S. Co. Rep. 4.

increase in surplus of over $100,000. During 1901 the National Salt Company made a net profit of $297,000 in various of its branches but suffered a loss of $275,000 through its contract with the Michigan Salt Association and a loss of $155,000 through the readjustment of the United Salt Company's accounts.[1] Altogether the book surplus of over $775,000 was reduced in one year to a book surplus of less than $70,000, a total decrease of over $700,000. Soon after the publication of this discouraging report, Nathan S. Beardslee, who had succeeded A. S. White in the presidency of the National Salt Company issued a statement that the "company had no surplus or money it could distribute as dividends and it cannot be stated when the Company will have enough earnings to allow it to declare dividends."[2] The deficit was directly attributable to the burdensome contracts with the Michigan Salt Associations which required the National Salt Company to purchase upward of 2,000,000 barrels of salt a year at prices considerably in excess of the market price. The new President remarks that the "existing debts were created before the present officers came into power."[3] They were, in fact, the outward indication of

[1] The following is an outline of the financial report of the National Salt Company for the year ending December 31, 1901.

Profit New York Department	$290,581		
Administration expenses, New York Department	160,445		
Net profit, New York Department		$130,136	
Dividends and miscellaneous income		156,465	
Total profit		$286,601	
Loss Michigan Department		275,738	
Total net income, National Salt Company			$10,863
Subsidiary companies' profit			28,052
Net income, National Salt Company and subsidiaries			$38,915
Book surplus, December 31, 1900	$778,949		
Sundries not credited in 1900	58,510		
Net income, December 31, 1901	38,915		
Total surplus	$876,374		
Erroneous credit to surplus for profit United Salt Company, year ending December 31, 1900		$155,314	
Dividends		651,172	
Deductions from surplus		$806,486	
Net surplus, December 31, 1901			$69,888
Redemption bonds, subsidiary company			40,000
Balance carried forward			29,888

Digest of report in 74 *Chron.* 678.

[2] Summary in 74 *Chron.* 678, March 29, 1902.

[3] 74 *Chron.* 678.

far extending clouds, which although long on the horizon were now beginning to assume ominous proportions.

The first suggestion of difficulties had arisen in April, 1901, when a minority stockholder of the United Salt Company of Ohio applied to the court for the appointment of a receiver on the ground that the Company was being mismanaged by the National Salt Company.[2] Receivers were presently appointed. When the National Company found its control of the salt business rapidly slipping away, it determined to relieve itself of the onerous terms under which it acquired the United Salt Company. It defaulted its July, 1901, payment of the Certificates of Indebtedness, and sought to repudiate the original contract with the United Salt Company on the ground of illegal restraint of trade.[3] In defense the public holders of the Certificates of Indebtedness, whose claims would be destroyed if the United Salt Company's contract was annulled, obtained from Judge Dickey, at a special term of Supreme Court, an injunction preventing the National Salt Company from transferring the assets of the United Salt Company to the International Salt Company.[4]

In August, 1902, the affairs of the National Salt Company had reached such a condition that a large part of the securities of other salt companies, held in its treasury, were offered for sale

[1] 1900 N. S. Co. Rep. See account of conditions.

[2] 72 *Chron.* 725. It had been reported at the time the Ohio Company was acquired by the National in 1899 that all the stock had been deposited under the collateral trust agreement.

[3] The instalments on the Certificates of Indebtedness had been regularly paid for a year and a half. The National Salt Company had admitted their legality in the supplement to the New York Stock Exchange Listing Application, signed by President White. The defense set up by the National Salt Company appeared, in view of the original intentions of the National Salt Company, somewhat humorous, had it not been for the fact that some of these Certificates had been offered by Stewart Barr and Company at 115 % as " first class, very remunerative " securities to small investors. (See circular of Stewart Barr and Co., 96 Broadway, p. 12.) The bill of complaint was to the effect that the United Salt Company and the International Salt Company had conspired in restraint of trade. It asked the Government to set aside the contract upon which the Certificates of Indebtedness rested.

[4] 73 *Chron.* 960.

at auction and bid in for \$450,000 [1] by agents acting for the International Salt Company. A short time afterward a judgment for \$238,098 was entered by default against the National Salt Company in favor of M. M. Belding, Jr., on notes payable on demand to the International Salt Company. During the first six months of the year the Company had lost over \$250,000 on its contracts with the Michigan Salt Association, and the entire business had produced a net deficit of \$174,714. Thus the current obligations exceeded the quick assets at that time by nearly \$300,000.[2] The condition of the Company reached such a pass that Chancellor Magie of New Jersey appointed receivers for the National Salt Company on September 29, 1902. The insolvency of the Company was evident from the statement of June 30th. This receivership was important, from the point of view of the International Salt Company, not only because of the protection it would afford its subsidiary in distress, but also because it would hasten the dissolution of the Company. A judicial sale of the assets of the National Salt Company would enable the International Salt Company to acquire possession of the Company's property without "settling" with the minority stockholders.

Other litigation arose. The minority preferred stockholders' Committee, mentioned above, brought suit to recover \$1,605,-

[1] 5,000 shares Anchor Salt Company.
1,932 shares Lone Star Salt Company.
2,000 shares Hutchinson-Kansas Salt Co.
250 shares J. T. Ewing Salt Co.
36 shares Walton Salt Association.
75 *Chron.* 397.

[2] 75 *Chron.* 736, October 4, 1902. J. Dobson Good, President of the Good Audit Company, in an affidavit to the New Jersey Court, upon which the receivership proceedings were based, reported; "Current obligations, June 30, 1902, including those due within sixty days, \$1,150,136, quick assets, \$858,418; deficit, \$291,718. During the six months ending June 30, 1902, the Company lost on its business \$174,714. Contracts with the Michigan Salt Company and others require the purchase of upwards of 2,000,000 barrels of salt a year at prices so much over the market that the National Company lost thereon more than \$255,000 in the half year. These contracts run to March 1, 1904. The Company has on hand more than 1,000,000 barrels of salt for which no market can be found at reasonable rates. . . ."

487 from the former Directors of the National Salt Company on the ground of wrongful acts.[1] Much discussion took place as to whether the Receivers of the Company were working for the interest of its stockholders or for the interest of the International Salt Company. Owing to the large minority stock outstanding these interests were not identical, so that when the various salt works in New York State were sold, by order of the Court, on September 15, 1903 for $337,500 to agents acting for the International Salt Company,[2] the Pomroy Committee appealed to the Court not to confirm the sale, on the ground that a conspiracy existed between the Receivers and the holding Company to defraud the minority stockholders of the National Salt Company. The Court, in response, refused to confirm the sale, on the ground that the price received was inadequate. It seemed that an appraiser had placed a value of $1,149,200 on the plants and had judged them worth $694,200 at forced sale.[3] Efforts were made to set aside the judgment of $238,098 against the National Salt Company, previously secured by M. M. Belding, Jr., acting for the International Salt Company, on the ground that the debt was contracted in order to pay unearned dividends.[4]

All these efforts of the dissatisfied security holders procured little permanent advantage. An agreement between the National Salt Company and the United Salt Company was finally reached, in which the two corporations were separated and the National Salt Company was relieved of its obligation to fulfill the contract with the United Salt Company under the onerous conditions involved in its Certificate of Indebtedness.[5] Unfortunately, however, the public holders of the Certificates had little security behind them except the stock of the National Salt Company, then almost worthless. Litigation over these certificates continued and was not finally settled until 1911.[6] The

[1] $1,055,000 on account of the Certificates of Indebtedness issued in exchange for the United Salt Co., $400,000 paid for alleged worthless patents and $150,000 excess above true value paid for the old Leroy plant.

[2] 77 *Chron.* 773, September 26, 1903.

[3] 78 *Chron.* 823. See Strickland *v.* National Salt Co. *et al.*, 88 *N. J. Suppl.* 323.

[4] 77 *Chron.* 1297.

[5] 77 *Chron.* 2342, December 19, 1903.

[6] 1912 I. S. Co. Rep. 2.

injunction sought by the minority stockholders of the National Salt Company to have the Receivers removed and to prevent the sale of the New York salt wells was denied April 25, 1904.[1] Accordingly the property was widely advertised and offered for public sale again.[2] At the time appointed by the Court there was very little interest shown in the sale and President E. L. Fuller of the International Company bid in the property for $193,310, less by $100,000 than the price received at the earlier, unconfirmed sale.[3] On December 28, 1904, Vice-Chancellor Stevenson signed an order dissolving the National Salt Company. The litigation over the Certificates of Indebtedness, issued in connection with the purchase of the United Salt Company, delayed the final liquidation of the Company's remaining assets, but the business of the Company passed finally into the hands of the International Salt Company.

The subsequent fortunes of the International Salt Company have little to show that is of interest. Harassed by agressive competition on all sides, and with the handicap of high rates of interest on its capital, it has been able to earn a meagre profit. In 1910 some of its properties in the West that had proved a burden were disposed of, and now the Company confines itself to the New York field.[4]

The failure of the National Salt Company affords one of the best examples of the evil results of an effort to raise prices through an attempt to control the total production of the country. The National Cordage failure was due to manipulation in all directions, the raw material, the finished product, and the market for the Company's securities. The National Salt Company's failure was due entirely to futile efforts to control the supply of a commodity the competitive production of which was inevitable, by the very nature of its manufacture. Encouraged perhaps by the measure of success attending the long history of the Michigan Salt Association the originators of the National Salt

[1] 78 *Chron.* 1552.

[2] New York papers. See description of property, *New York Evening Times*, March 30, 1904.

[3] 78 *Chron.* 2015, May 28, 1904. Sale confirmed. 79 *Chron.* 216.

[4] 1910 I. S. Co. Rep. 13.

Company believed themselves able to secure a high monopoly profit through a nominal control of the supply. Taking advantage of the inelastic market, the Directors of the National Salt Company reasoned that the earnings of that Company would increase proportionally with the increased price of salt. An increase of price could be secured only through an agreement with other manufacturers. To secure such an agreement the Directors entered into contracts for the purchase of the product of other manufacturers. These contracts could prove profitable only if the salt prices were successfully maintained on a high monopolistic level. For a year and a half their plan was attended with unqualified success. With an actual capital investment of hardly more than $2,000,000, the National Salt Company secured a net profit at the rate of well over $1,000,000 a year. But the very condition of high prices attracted new and aggressive competition. Over-supply was followed by falling prices, and the National Salt Company found itself unable to sell its rapidly accumulating stock of material. Efforts were made to extend its control through the formation of a holding company, but these efforts achieved no lasting benefit. The interests of minority stockholders, who refused to exchange their shares for the securities of the holding Company, were entirely extinguished in the bankruptcy and final liquidation of the National Salt Company.

CHAPTER IX

The United States Realty and Construction Company

The business of the George A. Fuller Company, 227; organization of the George A. Fuller Company of New Jersey, 228; the real estate companies entering the United States Realty and Construction Company, 230; promotion of the United States Realty and Construction Company, 230; Hallgarten syndicate, 232; value of assets of the Company, 233; early decline in value of Company's securities, 235; dissolution of the Hallgarten syndicate, 238; false methods of accounting, 239; disputes with labor organizations, 240; first plan of reorganization unsuccessful, 244; final and successful plan of reorganization, 246; summary of causes of failure, 248.

Chronological Summary

1901. Organization of the George A. Fuller Company of New Jersey.
1902. Promotion of the United States Realty and Construction Company.
1903. Early failure and dissolution of Hallgarten syndicate.
1904. First plan of reorganization unsuccessful.
Final and successful plan of reorganization.

The business of a real estate and building construction company may show distinct differences from that of a manufacturing company, but the points of resemblance are so striking that a comparison is valuable. Building construction, perhaps, more than any other industry, is susceptible to marked changes from periods of pronounced depression to periods of pronounced business activity. It is universally recognized that building operations increase during periods of expansion, and decrease or cease almost entirely during periods of depression. Thus the history of the United States Realty and Construction Company and its parent, the George A. Fuller Company, assumes interest in connection with general economic problems.

The George A. Fuller Company was originally an Illinois corporation engaged extensively in the construction of steel fireproof buildings. Beginning in a small way, it extended its business into the larger eastern cities. As the business grew,

it became the practice of the construction company to take the stock and bonds of real estate companies in part payment for labor and material, in exactly the way that the New England machinery companies take the stocks of cotton mills in part payment for equipment or electrical machinery companies take the bonds of local lighting and traction companies. Entered into at first as a means for stimulating construction, this part of the business grew so rapidly that the Company found it necessary to have access to considerable amounts of capital. Accordingly, a New Jersey corporation of the same name was formed on March 30, 1901, which took over the assets of the Illinois Corporation.[1] The interest of prominent New York bankers was enlisted, among them James Stillman, President of the National City Bank, and Henry Morganthau, President of the Central Realty Bond and Trust Company. The dominating spirit of the Fuller Company at the time was one Harry St. Francis Black, a Canadian by birth, who owed his position to the fact that he had married into the Fuller family. He was successful in enlisting the coöperation of other prominent men, but possessed himself less than ordinary business ability.

It was announced at the time the New York Stock Exchange listing application was filed that the George A. Fuller Company of Illinois had "securities, contracts, and property readily convertible into cash valued at $2,150,000." The tools, machinery and good-will, "the value of which was dependent upon the continuance of the business of the corporation," was valued at $10,000,000.[2] The promoters furnished $2,850,000 in cash making the net quick assets $5,000,000. Against this property was issued $5,000,000 in 7% preferred stock and $10,000,000 in common stock. In addition there were $5,000,000 of common stock not then issued, but which "may be issued on order of directors."[3] It would, therefore, appear that the George A. Fuller Company of New Jersey had issued preferred stock for

[1] Brief notes in 72 *Chron.* 678.

[2] Listing Application, New York Stock Exchange. Digest in 74 *Chron.* 1087, May 24, 1902.

[3] *Ibid.*

its net quick assets and common stock for its tools and good-will. There is every reason to suppose that the net quick assets were worth above $5,000,000, and its "good-will" was certainly valuable owing to its high reputation for the construction of steel buildings.

According to the information furnished the Listing Committee of the New York Stock Exchange, the Company entered into thirty-eight contracts for building construction during the first year of its existence. These contracts called for the payment of over $26,000,000. During the year its profit and loss account showed net income of over $1,500,000, and after having paid the regular dividends on its preferred stock and charged over $400,000, to depreciation, the Company was able to carry $589,-506 to surplus account. The balance sheet at the end of the year, March 31, 1902, showed nearly $2,000,000 in net quick assets, and about $4,000,000 invested in the bonds and stocks of buildings which the Company had constructed. There is every reason to believe that this favorable showing was reliable, but it should be remembered also that the year covered by the Company's business was a period of marked expansion. It marked the culmination of heavy building operations following the large expansion of trade that had started in 1897. It should not, therefore, be taken as an index of the Company's normal earning power.

Prompted partially by the initial success of the Fuller Company, partially by the ambition of Black to extend his operations in real estate, and partially by the contagion of the "consolidation movement," the promoters of the construction Company now sought to enlarge their operations in New York real estate. By the middle of July, rumors were current to the effect that a new consolidation was being arranged "with a capital stock probably not to be less than $65,000,000."[1] By August 1, the plans were sufficiently formulated for details to be given to the public. It was proposed to unite the Fuller Company with three real estate corporations, all operating in New York City, the Alliance Realty Company, the New York Realty Corporation,

[1] 75 *Chron.* 188.

and the real estate interests of the Central Realty Bond and Trust Company.

In the subsequent negotiations, the Alliance Realty Company [1] was dropped from consideration, but the other two interests were included. The New York Realty Corporation had been incorporated in New Jersey, May, 1901, by a powerful group of New York banking interests, including Edmund C. Converse, Charles Steele, James Speyer, Cornelius Vanderbilt. The Company engaged in acquiring real estate in New York City for speculation and investment. It was proposed to purchase from the Central Realty Bond and Trust Company only its real estate interests consisting of both developed and undeveloped parcels of real estate in New York City. Both of the new interests were, therefore, clearly real estate holding companies, the assets of which consisted of equities in lands and buildings.

The promoters of the consolidation purchased the real estate interests of the Central Realty Bond and Trust Company, and offered to acquire the outstanding stocks of the Fuller and New York Realty Companies by exchange. The conversion ratios are given in the table on the next page, showing the distribution of the securities of the United States Realty and Construction Company, as the new corporation was called. It was incorporated in New Jersey, August 4, 1902, with a capitalization of $30,000,000 in 6% preferred stock and $36,000,000 in common stock. Of these amounts, $2,500,000 of each class remained in the treasury unissued. There were no bonds, although the real estate holdings of the various subsidiary companies were encumbered with upwards of $2,947,000 of mortgages. In the circular letter sent to the stockholders of the New York Realty Corporation, certain men representing the interests concerned state that they proposed to receive a profit for organizing the new corporation and procuring the cash working

[1] The Alliance Realty Company had been incorporated January 27, 1900, as a New York Corporation. Its outstanding capital stock was $2,000,000. Several Boston financiers were interested in the Company, for example Charles F. Adams and Henry L. Higginson. It owned, with the George A. Fuller Company, the Broad-Exchange Building on the corner of Broad and Exchange Streets, New York City. (74 *Chron.* 381.)

ORGANIZATION OF THE UNITED STATES REALTY AND CONSTRUCTION COMPANY

	Old Companies			New Company					
	Preferred Stock	Contingent Charges	Common Stock	New Money	Preferred Stock		Contingent Charges	Common Stock	
					Single	Aggregate		Single	Aggregate
George A. Fuller Company:									
Preferred Stock	$5,000,000	$350,000	....	....	110 %	$5,500,000	$330,000	50 %	$2,500,000
Common Stock	....	....	$10,000,000	....	45 %	4,500,000	270,000	75 %	7,500,000
New York Realty Corporation	....	....	3,000,000	....	166⅔%	5,000,000	300,000	166⅔%	5,000,000
Central Realty, Bond, and Trust Company, realty only	....	....	....	....	....	1,500,000	90,000	....	1,500,000
Hallgarten Syndicate	....	..	....	$11,000,000	100 %	11,000,000	660,000	100 %	11,000,000
Promoters	....	....	...	....	....	....	....	....	6,000,000
Totals	$5,000,000	$350,000	$13,000,000	$11,000,000	....	$27,500,000	$1,650,000	....	$33,500,000

capital.[1] The promoters' profit seems to have consisted of $6,000,000 in common stock, or approximately 10% of the total issued securities. By 1902, it had come to be the recognized practice for the promoters of an industrial consolidation to look upon 10% in the common stock as their legitimate commission. In this case, the stock received as commission was worth about $1,800,000 at the very beginning, and had an average market value during the first year of $720,000.

The new working capital, which the promoters promised to furnish, was obtained through a syndicate. The provisions by which it was obtained were very important as one of the primary, although covert, purposes of the consolidation was the hope of the promoters to obtain a large fund of fluid capital. With this they proposed to enter numerous syndicate participations, then seemingly profitable, and to speculate in New York real estate. In all, $11,000,000 was subscribed. The members paid in, at the first instance 20% of their subscription and gave their notes for 60%. A bank advanced the remaining 20% on the syndicate account.[2] The syndicate received $100 in preferred stock and $100 in common stock from the United States Realty and Construction Company for each $100 paid into the treasury. It was created largely through the influence of James Stillman, of the National City Bank, although such was the confidence in industrial combinations and such had been the profits of previous promoting syndicates that little difficulty was experienced in obtaining subscriptions. Practically every important financial interest in New York City was more or less

[1] The letter of August 6, 1902, to the stockholders of the New York Realty Corporation, was issued by James Stillman, Henry Morgenthau, H. S. Black, Albert Flake, and Robert E. Dowling — all of whom were prominent in one or more of the companies which it was planned to consolidate. The letter further states that "all of the undersigned and our associates are stockholders, officers, or directors in one or more of the companies named above (the companies to be taken over), and it is proper to state that we expect to receive for the responsibilities and risks assumed by us in organizing the new corporation, procuring the cash capital and for the expenses incurred, an individual profit which will or may include the stock of the new corporation remaining in our hands after carrying through the transaction."

[2] Brief accounts of the syndicate given at time of dissolution in 77 *Chron.* 717 (September 19, 1903) and *New York Tribune*, September 12, 1903.

interested.[1] The subscribers included the Equitable and New York Mutual Life Insurance Companies, the National City and other prominent banks and trust companies, officials of the United States Steel Corporation. The individual subscribers were legion. Hallgarten and Company acted as managers and received in compensation $220,000 or 2% of the capital amount.[2]

It is difficult to estimate the actual tangible assets acquired by the United States Realty and Construction Company. A little over a year before, the Fuller Company had $5,000,000 in property and net quick assets. This amount had been actually increased through the business by at most $1,000,000, although the surplus account amounted to nearly $3,000,000 when it was taken over by the United States Company.[3] Its investment standing was excellent, the preferred stock was then selling above its par value.[4] The New York Realty Corporation owned five pieces of property, and part interest in two other pieces. Altogether the property was probably worth about $2,500,000, but it was encumbered by mortgages aggregating $1,200,000.[5] In addition the Corporation held $2,144,563 in mortgages and some miscellaneous assets so that all the property of the Corporation had a value of not over $3,500,000.[6] The capital stock was $3,000,000. During the preceding 16½ months, the apparent profits of the Company amounted to $1,470,490, out of which dividends at the rate of 10% per annum had been paid. It should be noted, however, that nearly half this apparent profit was shown by crediting the profit and loss account with $603,221,

[1] The *Commercial and Financial Chronicle* remarked at the time, referring to the subscribers, "nearly every important financial interest in this city." (75 *Chron.* 294.)

[2] 77 *Chron.* 717.

[3] New York Stock Exchange Listing Application, A-2698, dated October 13, 1902. Summary, 75 *Chron.* 1200.

[4] The following is a summary of the market quotations of the Fuller securities, — the George A. Fuller Company of New Jersey:

Month	Common Low	Common High	Preferred Low	Preferred High
June, 1902	48⅛	53	94½	97⅞
July, 1902	49	64	94¼	108
August, 1902	59⅛	62	102½	108⅞
September, 1902	58	58	104¼	105

[5] New York Stock Exchange Listing Application, A-2698.

[6] This is a liberal estimate based partially on balance sheet of September 15, 1902, and partially on assessed valuations.

from "increase of valuation of real estate and stocks owned." The Central Realty Bond and Trust Company conveyed to the United States Realty and Construction Company only its real estate interests. These consisted of some thirteen New York City lots and a half interest in others, property burdened with mortgages, to the amount of $1,319,000.[1] The equities were worth certainly not more than $1,500,000. Altogether, then, it would appear that the United States Realty and Construction Company commenced business with actual real estate and other tangible property to the value of approximately $11,000,000, and with $11,000,000 in money, — $22,000,000 in all. Against this was issued $27,500,000 in preferred stock, and $33,500,000 in common stock, — $61,000,000 in securities.

In spite of the unsubstantial ratio between property and capitalization, the history of the earning power of the constituent companies augured well for the new holding corporation. From its organization until taken over by the United States Company, the Fuller Company had earned an average of $2,418,374 [2] a year, — this on invested capital, confessedly worth only $5,000,000. The good-will and organization of the Fuller Company might, therefore, be considered rightly of great value.[3] The New York Realty Company had been earning at the rate of $900,000 a year, and the equities of the real estate acquired from the Central Company had a reported earning capacity of approximately $500,000. Altogether the earnings of the subsidiary companies were reported to be at the rate of about $3,800,000 a year, but a large part of this amount, certainly $1,000,000, was obtained by assuming as earnings the supposed increased value of real estate. The 6% cumulative dividend on the United States Realty and Construction Company's preferred stock called for an annual disbursement of only $1,650,000.

The shares of the United States Realty and Construction Company were admitted to the list of the New York Stock

[1] New York Stock Exchange Application, A-2698. The mortgage debt on the blocks of which the Central Company had only a one-half interest have been pro-rated.

[2] *Ibid.*

[3] Furthermore the market values of the Fuller Company's stocks were relatively high. (See note on p. 233.)

Exchange, and were quoted for the first time on October 30, 1902, — $75.50 a share for the preferred stock and $32 a share for the common stock. These were the highest quotations ever attained for the securities. On the basis of these quotations, the United States Realty and Construction Company had a market valuation slightly in excess of $30,000,000, and the members of the Hallgarten syndicate had an apparent profit of something less than $1,000,000. The market prices of the securities began to fall almost the day following their initial quotations. No reason could be discovered, as the strongest financial interests were supporting the enterprise, and regular dividends were paid on the preferred stock. At the end of the first half-year of the Company's business, the *New York News Bureau* [1] published an "authoritative statement" to the effect that the earnings for the six months were $1,600,000, and that the Company had on hand construction contracts to the amount of $23,000,000. "The assured profits on these contracts will exceed $2,000,000." At the time of this announcement, the preferred stock was quoted at $68 a share, and the common stock at $22. The Hallgarten syndicate could at that time be liquidated only at a loss. It was evident that the syndicate was in possession of a large part of its original holdings and the conditions of the market were such that its managers could not sell these securities except at a considerable loss. In the meantime, the promoters of the Company had secured a truly remarkable Board of Directors, representing as it did numerous strong financial interests. From collateral evidence it is clear that men had permitted the use of their names on the Board of Directors on account of the importance of the Hallgarten syndicate, but had assumed little responsibility on behalf of the Company, and knew next to nothing about it.[2] The specific management of the enterprise was then, as previously, in the hands of Black and his associates.

By July 23, 1903, less than a year after the Company had started on its career, the market value of the preferred stock had

[1] Quoted in 76 *Chron.* 927.

[2] Of this Board of Directors the *New York Evening Post* made the following comment: "Realty stock was set afloat with one of the most extraordinarily

fallen to $46 a share, and that of the common stock to $9. This represented a market value for the Company of approximately $15,500,000, — hardly more than the amount that had been paid in money, at the time the Fuller and the United States Realty Companies were promoted. On that date, the Company's officials, fearing a panic in its securities, issued an exhaustive statement [1] to the effect that the United States Realty and Construction Company and its two subsidiaries had on deposit at the banks a little less than $4,000,000, together with other stocks, bonds, mortgages, and equities aggregating in all over $12,000,000.[2] These statements were no exaggeration. There is no reasonable doubt but that the actual property owned by the Corporation amounted to well over $16,000,000, including the $11,000,000 in cash received by the Company from the syndicate, but without regard to the good-will of the Fuller Company. Unfortunately, the syndicate's money had been largely invested in more or less speculative securities and syndicate participations upon which the Company had sustained severe losses.[3] The general security market underwent a marked decline between the summers of 1902 and 1903 which aggravated, to a considerable degree, the general feeling of uncertainty.

The discrepancy between the assets and the market value of the Company's securities was due to forbodings of ill. Two

composite Boards of Directors, in point of character, that was ever named even in those days when eminent bankers and vulgar gamblers grew used to sitting harmoniously side by side in the committee of new corporations. The virtuous directors, as usual, served as a guarantee which the wicked directors, as usual, could not entirely efface in the public view." — *New York Evening Post*, May 28, 1904.

[1] 77 *Chron.* 206.

[2]

Cash		$3,982,162
Stocks and bonds	$6,080,000	
New York City mortgages	4,190,000	
New equities	2,370,000	12,640,000
		$16,622,162

[3] For example the Company was carrying large interests in the preferred and common stocks of the National Fireproofing Company, then having only a nominal market, and over 5,000 shares of United States Steel Corporation's preferred stock. It had participated in numerous syndicates including the Underground Railway of London, and the Denver and Northwestern Railway.

weeks after the publication of the "official statement" a full account of the condition of the Company for the nine months ending June 30, 1903, was made public. It then appeared that the earnings for the period aggregated only $1,417,686 of which $487,625 was "profit from estimated increase in value of investments still held" [1] and $576,773 was "profit on buildings in progress, estimated proportion accrued." [2] The net earnings, without these questionable entries were then only $353,278. In the nine months $1,218,889 had been paid in dividends. The United States Realty and Construction Company, although merely a holding corporation and presumably under no direct expense, had charged to expenses $564,863, a considerable part of which was officers' salaries and general expenses.[3] Had the

[1] The accountants permitted the marking up of the value of two pieces of real estate which the Company had leased during the year. The increased value was regarded as income.

[2] The following system of taking, as earned, profits on buildings in the process of construction was adopted by the two accounting firms making the audit: (*a*) On buildings where less than 1/3 total cost was expended, no profits were taken; (*b*) where 1/3 to 2/3 total cost expended, 50 % estimated profit taken; (*c*) where expenditures exceeded 2/3 the total cost, 75 % profit was taken; (*d*) the remaining 25 % acting as a reserve until the buildings were finally completed and the payments all made.

[3] Figures in this paragraph from report of Jones, Caesar & Company and Marwick, Mitchell & Co., reprinted 77 *Chron.* 297, August 8, 1903.

INCOME ACCOUNT FOR NINE MONTHS ENDING JUNE 30, 1903.

Interest receivable		$310,657
Income from investments:		
Real estate	$98,423	
Rent, interest in real estate, and securities	74,548	
Stocks and bonds	75,910	248,881
Profit on building contracts:		
Completed	230,071	
In progress	576,773	806,844
Profits on realty and investments		228,800
Miscellaneous		106,952
Total profits		$1,702,134
Deduct:		
Interest payable	207,210	
Expenses of management:		
Office salaries	67,323	
Employees' and commissions	132,560	
General expenses	364,980	772,073
Net over charges		$930,061
Profit from estimated increase in value of securities still held		487,625
Total		$1,417,686
Dividend on preferred stock, 4½%	$1,215,499	
Dividend on outstanding stock of subsidiaries	3,390	1,218,889
Balance carried to balance sheet		$198,797

managers merely invested the $11,000,000 of money received from the Hallgarten syndicate in securities yielding 5% interest, they would have obtained $412,500, or more than the actual net earnings of the entire organization.

On September 11, 1903, the Hallgarten syndicate was dissolved. It was planned to continue it until November 1st, but conditions in the stock market made it undesirable to have the large holdings remain longer unabsorbed. Furthermore, the bank which had consented to finance the syndicate to the extent of 20% of the cash advanced had become worried and called for more margin. The results of this syndicate are in sharp contrast to those of many other syndicates organized within the previous four years, in connection with the promotion of promising industrial consolidations. The managers of the syndicate had originally acquired 110,000 shares of the preferred, and 110,000 shares of the common stock. Soon after organization and before the stocks were admitted to the list of the New York Stock Exchange, the managers sold 60,000 shares of the common stock at approximately $37.50 a share. They refused an offer of $35 a share for the remainder.[1] With a large part of these proceeds, they purchased about 27,000 shares of the common stock, and about 17,000 shares of the preferred, at prices very much less than those at which they had acquired the stock from the Company. At the time it was dissolved, after Hallgarten & Company had taken $220,000 for their services, the syndicate was in possession of 127,050 shares of preferred stock, 77,220 shares of common stock, and about $675,000 in money. Approximately $500,000 of this amount had been received from the dividends on the preferred stock, so that the money profits of the syndicate operations amounted to only about $175,000. On the day the syndicate was dissolved, the preferred stock was quoted at $36 a share, and the common stock at $6.50 a share. Including the money actually returned to the members at the time, the total value of its holdings may be estimated at $5,250,-

[1] Statement of member of syndicate and a number of the Board of Directors of United States Realty and Construction Company. *New York Sun*, September 15, 1903.

000, less than one-half the amount subscribed by the members at the time of the formation of the United States Realty and Construction Company.[1]

A week after the dissolution of the Hallgarten syndicate, the Directors of the United States Realty and Construction Company passed the fourth dividend on the preferred stock "because the Company had not earned the money."[2] Behind the failure of the Hallgarten syndicate and the United States Realty Company lay the financial depression of the summer of 1903, with the severe liquidation of industrial stocks. The market for the securities of business consolidations had disappeared, and the Realty promotion, coming at the very end of the period of promotion, had to bear the brunt of the burden. Even the United States Steel Corporation's common stock had suffered severely, and was then selling at $20 a share. But back of the general conditions of the market, there were three underlying causes which served to accentuate the lack of confidence in the United States Realty and Construction Company. Two of these causes were concerned with the methods of accounting, tolerated by the Company's management, and the third with the relations that developed between the Fuller Company and its employees.

The United States Realty and Construction Company had followed the policy, earlier practised by the Fuller and the New York Realty Corporation, of admitting, as net earnings of the year, the appreciation in the holdings of real estate. Net earnings, computed on this basis, had been credited to surplus account, applicable to dividends. The plan was objectionable because of the natural tendency of the officials to appraise their property at an unwarranted figure, and the manifest difficulty of using mere appreciation as a quick asset out of which to meet the cash requirements of dividends. Appreciation of real estate

[1] According to an officer of the Central Realty Bond and Trust Company, which had acted as agent for the syndicate managers in the distribution, each member of the syndicate received on the basis of each $1,000 contributed $1,155 in preferred stock, $702 in common stock, and $61.66 in money. Of this money $45 was represented by dividends on the preferred stock held by the syndicate.

[2] 77 *Chron.* 717, September 19, 1903.

might have found its way into surplus, had the Company been engaged in buying and selling property, in which case the profits realized through sales might be credited to net earnings. But the Company was not engaged in this business, nor had it sold any property upon which a profit could be taken. Furthermore, where appreciation occurs, depreciation is quite as distinct a possibility, and the public accountants had showed clearly that the Company had not charged to the net earnings account the losses sustained through the depreciation of certain of its securities. To admit as net earnings the increases in value, and omit the losses could have but one outcome.

Another vicious accounting practice tolerated by the officers of the Fuller Company was that of crediting net income with "earned" but unrealized profits on building contracts. A similar practice was adopted by the United States Shipbuilding Company, which suffered the misfortune of finding that before contracts were completed the anticipated profits of millions had turned into a heavy loss. The error of this method of accounting, lay in the fact that it was impossible to determine exactly the proportionate amount yet to be done on a building. Unless this could be determined exactly, it was obviously impossible to estimate the margin between the cost of the unfinished structure and the proportion of the contract price already earned. Again net earnings were made to depend on an estimate, and the estimate, moreover, was in the hands of the officers of the Company. Just before the United States Realty and Construction Company became seriously embarrassed, the officials of the Corporation realized the unsubstantial basis upon which depended such taking of profits before they were realized, and discontinued the practice. The announcement of the change was, however, too late to help maintain public confidence in the Corporation's securities.

The fundamental difficulty with the earning power of the United States Realty and Construction Company lay in another direction. The Fuller Company was in serious difficulties from its relations with labor organizations. Building operations have always suffered from strikes and labor disputes, and large

office buildings, requiring a high grade of specialized labor for their construction, have been particularly susceptible to the influences affecting the labor market. Beginning in 1897, and extending through 1902, there was extensive building all over the United States. This movement was especially felt in New York City, where large amounts of capital were spent. Wages, therefore, rose rapidly in all the building trades. On account of the relative scarcity of labor, and the pressure on the employers to fulfill their contracts at a specified time, the labor unions acquired great power. The union of iron workers was especially strong. To resist its demands, certain employers in New York City formed an association known as the Iron League. Closely connected with the Iron League, but formed to cover a broader field, was the Building Trades Employment Association. The Structural Iron Workers' Union demanded in April, 1903, an advance in wages from 50 cents an hour to 56¼ cents, beginning May 1, 1903. The employers belonging to the Iron League not only refused the demands, but also refused to have anything further to do with the Structural Iron Workers' Union, unless the representatives of the latter consented to sign a general arbitration agreement. As a result a "lock-out" was declared by one side and a "strike" by the other.

With these difficulties, however, the Fuller Company was not concerned. As one of the largest employers of labor, it had refused to become a member of the Iron League, or the Employers Association,[1] believing that it could arrange its difficulties with the unions directly. It had accordingly signed a special and secret agreement in the spring of 1903, and the members of the unions had continued to work on the buildings under construction by the Fuller Company. This policy had, however, antagonized the other contractors, who felt that the Fuller Company had jeopardized the interests of the employers. It did not, moreover, insure the Fuller Company against other difficulties with its employees. The first of these difficulties arose over a delay in the finishing of a building which the Fuller Company

[1] The Fuller Company had been a member of the Association, but was expelled because of a refusal to pay a fine of $500.

was constructing for the Butterick Publishing Company.[1] Most serious, however, was the difficulty with the masons, which arose in November. At a former time the Fuller Company had been a member of the Mason Builders' Association, which had agreed with the Bricklayers' Union not to sublet any contracts on fireproofing, the laying of brick floors and the like, but to employ the masons who were working on the walls. The Fuller Company was no longer a member of the Association, and believed itself not bound by the agreement. Accordingly the Company sublet the fireproofing on a building to the National Fireproofing Company, a large interest in which the United States Realty and Construction Company had purchased with a part of the money received from the Hallgarten syndicate. The Fireproofing Company employed its own men instead of bricklayers already on the premises.[2] As a result a strike was extended to all buildings then under construction by the Fuller Company. On the same day, for an entirely different cause, the stone cutters also struck. This stopped the work on all the Company's buildings at once, as employees in other trades were thrown out of work. In order to fulfill its contracts, the Fuller Company finally granted all the demands of the Bricklayers' Union even to the extent of allowing the men pay for "waiting time" to the amount of $1,500 a day. Three days after the settlement with the bricklayers, the structural iron workers, with whom the Fuller Company had maintained amicable relations, owing to the agreement

[1] This incident had its dramatic touch. It appeared that the contract for the building called for completion by August 1, 1903. The Fuller Company became entangled in a controversy between two different kinds of structural iron workers' unions. They sublet the contract, but the work lagged until the Butterick Company demanded that the Fuller Company leave the building, the upper stories of which were unfinished. They refused. About midnight on October 6th a force of men under the employ of the Publishing Company went to the building for the purpose of occupying it. They found that the Fuller Company had engaged armed men to hold the building who, behind barricaded doors, resisted all assaults. The matter was subsequently settled between the parties, but a great deal of newpaper notoriety was attracted to the Fuller Company at the very time the securities of the United States Realty Company had declined in market value to their lowest points. (For accounts see *New York Tribune*, October 7, 8, 9, 12, 1903.)

[2] *New York Tribune*, November 12, 1903.

signed the previous April, left their work because the Company had sublet the placing of some ornamental iron work to a member of the Iron League.[1] Thereupon the Fuller Company joined the Iron League and the affiliated Employers' Association.[2] As a result of these events, sympathetic strikes were called on buildings in process of erection by the Fuller Company in Chicago and elsewhere. Work was stopped on the large depot the Company was building for the Wabash lines in Pittsburg, and it was finished by the railway company.[3] Other controversies and strikes continued into the following year.[4]

All these difficulties reflected unfavorably on the standing of the Fuller Company, and market value of the securities of the United States Realty and Construction Company.[5] The financial history of the latter company had been running far from smoothly during the time the labor controversies of the Fuller Company were in progress. On November 18, 1903, Vice-President Robert E. Dowling stated that the amount of construction business had fallen off between 30% and 40%.[6] On the following day a Committee of Directors,[7] men who had been led into the enterprise by the representations of Black and his associates,

[1] *New York Tribune*, November 22, 1903.

[2] *Ibid.*, December 30, 1903.

[3] 78 *Chron.* 51.

[4] A long controversy with the bricklayers' carriers began March 8, 1904, in the settlement of which the Fuller Company finally enlisted the help of non-union men. *New York Tribune*, March 9, 15, 16, 19, 25, April 7, 1904.

[5] The feeling of hopelessness is evidenced by the following statement given out by a representative of the Fuller Company at the beginning of the troubles. "On account of labor troubles and the consequent depression in the building industry, we have reduced our working force very considerably. We have discharged all our estimaters but the chief estimater, and have reduced the force greatly in all other departments, but we are not going out of business. Other contracting firms are also reducing their forces on account of discouraging conditions. We shall finish the contracts on hand, but will undertake very little new work until the building conditions are more stable. In fact there is very little new work in sight, as investors, owing to the unsettled state of the building trade, will not invest. The constant strikes and lock-outs of this season have brought about a stagnation in the trade from which everyone is suffering." *New York Tribune*, November 18, 1903.

[6] 77 *Chron.* 2039.

[7] James Speyer, Chairman.

but who knew next to nothing about it, became alarmed at the low prices of the Company's securities[1] and the general lack of confidence in the management of the Company. This Stockholders' Committee, admittedly constituted as a protest to the Black management, requested all stockholders to deposit their securities with the Equitable Trust Company, that it might "secure some radical changes in the administration of the Company, especially in its construction department."[2] Later all the stock deposited was returned to the stockholders.

In the meantime, H. S. Black and his associates, taking advantage of the low price of the Company's securities, had acquired large blocks of the common and preferred stocks on the open market. A majority of the outstanding stock came, at the time, under the control of H. S. Black and James Stillman. At this juncture, thirteen of the directors resigned.[3] The number included some of the strongest banking interests that were behind the Company. Soon after securing control, Mr. Black was elected President and in the subsequent reorganization, his influence was dominant.

During the latter part of January, 1904, the securities of the United States Realty and Construction Company rose rapidly in their market value on the strength of a rumor that a reorganization was imminent in which bonds would be given in part payment for the outstanding preferred stock. This rumor took definite form in the announcement of a plan, supposed to have been advanced by a sub-committee headed by James Stillman. According to this plan, the capital stock would be cut to $14,-

[1] Preferred stock, $35.75. Common stock, $5.50.

[2] "As owners and representatives of owners of large amounts of the capital stock of the United States Realty and Construction Company, we have, after full consideration, determined to request the stockholders to confer upon us powers, as a Stockholders' Committee, which will enable us to secure some radical changes in the administration of the Company, especially in the Construction Department, and to establish an administration of the Company's affairs, which we believe will be advantageous to the stockholders, and will secure for the Company the confidence of the communities in which its business is to be transacted." Section 1, Circular to Stockholders, dated November 19, 1903.

[3] Among them, E. C. Converse, James Speyer, Cornelius Vanderbilt, and Charles F. Adams. 78 *Chron.* 233.

950,000 par value, all of which was to be of one class. In addition, the new company would issue $21,000,000 of first mortgage 4½% bonds. The holders of the old preferred stock would receive 70% of their holdings in bonds, and 30% in new stock. The owners of the old common stock would receive 20% of their holdings in new stock.[1] The proposed changes may be seen from the table given on page 247. From a comparison of the securities of the two companies, it is obvious that the total capitalization was to be cut down from $61,000,000 to $34,200,-000 or about 43%. Yet at the same time, the Company was to be burdened by $866,000 in fixed charges and $19,250,000 in funded debt, although the charges ahead of the common stock were cut from $1,650,000 to $866,250. The weak point of the plan was that bonds were created where there were none before, and that although the new charges were less in amount, they were fixed and not contingent.

On the announcement of the plan, much discussion arose. Considerable criticism centered on that feature of it which proposed to issue bonds for preferred stock. It seemed to some of the critics "like going into debt, and getting nothing in return." On the other hand, many people were of the opinion that the preferred stockholders were treated too liberally. As stockholders they should share in the risks of the business, and to give them bonds for nearly three-fourths of their holdings was obviously unfair to the holders of the common stock. On the other hand, the preferred shareholders contended that the common stock was all "water" and that they were entitled to the premier securities, as their stock represented the actual property of the old company.[2]

In the discussions other plans were suggested. One that was widely talked of proposed to give the preferred shareholders 60% of their holdings in bonds, and the common shareholders 30% in new stock. Another plan proposed to give the preferred shareholders only 35% of their holdings in bonds. It seemed to

[1] 78 *Chron.* 587.

[2] See letter of dissatisfied preferred stockholder, dated February 16, 1904. *New York Evening Post.*

be the consensus of opinion that the contingent charges ought to be reduced, and the only way to accomplish this end seemed to be to induce the preferred shareholders to accept a better security, provided they consented to undergo a reduction of income.[1] With this as an excuse, all the proposals involved the creation of a bonded debt.

Finally by the middle of May, 1904, a definite plan was agreed upon which seemed to be acceptable to the majority of the interests of the Realty Company.[2] It was similar in general outlines to the earlier plan, but differed in details. The new corporation, to be called the United States Realty and Improvement Company, was to have an authorized capitalization of $30,000,000, the stock being all of one class. A little over $16,000,000 of the stock was to be issued at first, and the rest was to remain in the treasury for use in the conversion of bonds. In addition to the stock, the new Company was to issue a little over $13,500,000 of 5% twenty-year debenture bonds, convertible within time limits into the stock of the Company. It will be remembered that the bonds in the former plan bore only 4½% interest, but were covered by a mortgage. The new plan proposed to give bonds to the value of 50%, and new stock to the value of 42½% for the old preferred stock, and new stock to the value of 15% for the old common stock.[3] The table on the next page suggests the details of operation of the new plan.

On comparison with the outline of the preceding plan, it is clear that both the charges and the outstanding capitalization were further reduced. The new fixed charges were only $687,500, and the total outstanding capitalization was reduced to $30,000,000. The same serious objection to creating a debt and changing a contingent charge to a fixed charge held true of this final plan, quite as much as of the tentative one.

As Mr. Black and Mr. Stillman controlled a majority of the stock of the old company and approved of the plan, success

[1] It should be remembered that the United States Steel bond conversion plan was then being discussed widely.

[2] 78 *Chron.* 2019.

[3] See plan outlined in letter to stockholders, May 25, 1904, especially Section 3.

	United States Realty and Construction Company			First and Unsuccessful Plan of Reorganization					Second and Successful Plan of Reorganization				
	Preferred Stock	Contingent Charges	Common Stock	Bonds		Fixed Charges	Common Stock		Bonds		Fixed Charges	Common Stock	
				Single	Aggregate		Single	Aggregate	Single	Aggregate		Single	Aggregate
Preferred Stock	$27,500,000	$1,650,000	....	70%	$19,250,000	$866,250	30%	$8,250,000	50%	$13,750,000	$687,500	42½%	$11,687,500
Common Stock...	....	....	$33,500,000	....	....	..	20%	6,700,000	....	....	....	15 %	5,025,000
Totals	$27,500,000	$1,650,000	$33,500,000	....	$19,250,000	$866,250	....	$14,950,000	. ..	$13,750,000	$687,500	....	$16,712,500

SUMMARY	Old	New	Proposed Change Amount	Proposed Change Percentage New to Old	New	Accepted Change Amount	Accepted Change Percentage New to Old
Securities bearing Interest	...	$19,250,000	+$19,250,000	..	$13,750,000	+$13,750,000	....
Securities bearing Interest and Contingent Charges	$27,500,000	19,250,000	− 8,250,000	70%	13,750,000	− 13,750,000	50%
Total Securities	61,000,000	34,200,000	− 26,800,000	57%	30,462,500	− 30,537,500	50%
Fixed Charges	...	866,250	+ 866,250	.	687,500	+ 687,500	....
Fixed and Contingent Charges	1,650,000	866,250	− 783,750	52%	687,500	− 962,500	41%

was therefore assured. By the middle of June, 1904,[1] it was declared operative, and in due time practically all the securities of the United States Realty and Construction Company were exchanged for those of the United States Realty and Improvement Company.

The failure and subsequent reorganization of the United States Realty and Construction Company turned upon an over-estimation of the earning power of a company engaged in the construction and renting of costly urban real estate. The business of the Company was actually divisible into two parts, that conducted by the Fuller Company, and that by the New York Realty Corporation. Both were seriously affected by the general depression that commenced in the autumn of 1902. They showed large earnings during the preceding years of activity, and their consolidation was promoted with the expectation that these large earnings would continue. The contraction of credit curtailed building construction, and disputes with labor unions paralyzed the Fuller Company. Speculation changed the possible earnings of the other branches of the business to losses, and false methods of accounting aggravated the feeling of uncertainty in the minds of investors. These factors made it clear that the business had not the earning capacity its promoters had anticipated, and the reorganization turned merely upon the reduction in capital charges. A large contingent charge was changed into a smaller fixed charge.

[1] 78 *Chron.* 2446

CHAPTER X

The American Bicycle Company

Early history of bicycle industry, 249; promotion of American Bicycle Company, 251; early management, 255; first published statement, 256; failure of the American Bicycle Company, 257; reorganization plan, 259; failure of the Pope Manufacturing Company of New Jersey, 263; reorganization plan, 265; summary, 268.

Chronological Summary

1890. Beginning of the bicycle industry.
1897. Popularity of the bicycle reaches its climax.
1898. Promotion of the consolidation.
1899. American Bicycle Company commences operations.
1900 First published statement.
1902. Failure of the American Bicycle Company.
1903. Reorganization into the Pope Manufacturing Company of New Jersey.
1907. Failure of the Pope Manufacturing Company of New Jersey.
1908. Reorganization into the Pope Manufacturing Company of Connecticut.
1913. Failure of the Pope Manufacturing Company.

The failure of the American Bicycle Company was a conspicuous example of financial distress consequent on the collapse of an entire industry. The use of bicycles became so extended from 1892 to 1895 that it could be called a craze. The craze reached its height in 1897. It was maintained with but slightly lessened intensity to 1900, when it ceased even more suddenly than it had arisen. Public taste, fickle at all times, and especially fickle regarding its amusements, became suddenly weary of its plaything, and threw it aside. Millions of dollars worth of property invested in the manufacture of bicycles consequently became worthless.

Soon after the close of the Civil War, there was a period of pronounced popularity of the men's "tricycle." This fad died down as quickly as it had arisen. Col. A. A. Pope, the father of the bicycle industry in this country, saw the English big-wheel machine at the Philadelphia Centennial, and was instrumental in having a few machines imported into this country

as an experiment. These proved a success, and he looked about for an opportunity to have them manufactured in this country. The Weed Sewing Machine Company undertook for him the manufacture of bicycles in this country at its factory in Hartford, Connecticut. In course of time, Col. Pope secured control[1] of the Company and the name was changed to the Pope Manufacturing Company.[2] The popularity of the bicycle grew rapidly after 1892. As there were few if any important basic patents in the industry, competition sprang up all over the country, attracted by the liberal profit and the apparently bright future of the business. Mr. George Pope, in his affidavit to the Industrial Commission, testified that "the business had been very profitable up to 1895."[3] This year was, in fact, the year of greatest profits, although not of the greatest production. At the end of the season the manufacturers, everywhere, found the demand in excess of the supply. Local dealers were unable to furnish enough machines for their customers and manufacturers were unable to fill their orders from dealers. The conditions indicated a young industry in which public demand for a new commodity had arisen suddenly, without adequate provisions for supplying it. Those manufacturers, who could supply the commodity were able to secure inordinate profits.[4]

By the very nature of the circumstances, this period of large earnings was of short duration. An industry in which the returns are large soon attracts new capital and new business ability. The excessive profits of the year 1895 were put back by the

[1] At the time in question the sewing machine business was suffering a depression, and the Weed Sewing Machine Company was in difficulties. Col. Pope gave the Company so many orders that the sewing machine works were gradually transformed into a bicycle factory. Meanwhile, Pope purchased a minority interest in the sewing machine company's stock and subsequently the absolute control.

[2] The original Pope Manufacturing Company was organized in Boston by Col. A. A. Pope to exploit certain small inventions. The capital was small, — $10,000. After the assumption of the Weed factory the bicycle business became its chief, if not its only, business.

[3] XIII *R. I. C.* 689.

[4] It was an excellent example of what Professor Marshall would call "quasi-rent," inordinately large earnings due to fortunate economic conditions.

manufacturers into new machinery, new factory buildings, and other forms of fixed capital. The succeeding year showed a marked increase in production, but the manufacturers and dealers were able to fill all their orders. Supply had met demand and, temporarily at least, the industry was at equilibrium. During 1897, competition had become so keen that the net earnings, judging from the figures available for the largest manufacturers, were less than a half what they had been during the preceding year. During 1898, the competition had increased rather than diminished, although many of the smaller plants had been eliminated from the field. The prices to the ultimate consumer were not reduced by an amount commensurate with the increased competition, but each manufacturer assumed enormous selling expenses in order to maintain the popularity of his particular make of bicycle. Racing teams, the members of which received large salaries from the manufacturers, traveled about the country for advertisement purposes; elaborate booklets were widely distributed, and each dealer spent a considerable fraction of his total receipts in "bill-board" and magazine advertisements. In spite of these heavy selling expenses, the older, better established manufacturers were able to obtain a small profit, but the industry was rapidly approaching a serious depression through over-production alone. The manufacturers' stocks of bicycles, left over at the end of the year, steadily increased after 1897.

One day in the late summer of 1898, Col. J. J. McCook, of the law firm of Alexander and Green, suggested to Mr. A. G. Spalding,[1] that it might be expedient to form a combination in the bicycle industry.[2] The suggestion was very favorably

[1] President of the Lamb Manufacturing Company of Chicopee Falls, manufacturers of the Spalding bicycle.

[2] As reviewed to the present writer, the conversation was something as follows:

Col. McCook. Have you observed the movement toward combination apparent everywhere?

Mr. Spalding. Yes.

Col. McCook. Have you ever thought of the possible application of the combination idea to the bicycle industry?

Mr. Spalding. Not seriously.

Col. McCook. I wish you would think it over, it seems to be working in many other cases.

received, and Spalding, with the help and legal advice of Alexander and Green, secured options on a large number of bicycle plants, — estimated at first in the *Commercial and Financial Chronicle*, as those of "more than one hundred makers." [1] The actual number of options appears to have been 107.[2] As a matter of fact, only forty-eight of the plants out of the total were finally purchased by the promoter of the consolidation,[3] but these included the Pope Manufacturing Company, and all the largest factories in the industry. They controlled upwards of 65% of the country's entire output of bicycles. These forty-eight plants had made, altogether, average net profits of over $3,500,000, for the two preceding years, and average net profits of nearly $5,000,000, for the preceding four years.[4] Even allowing for exaggerations of statement, there is every reason to believe that the constituent manufacturing companies were earning liberal profits. And it was hoped to further increase their collective earnings by introducing economies of combination and large-scale production, then widely believed in by public and manufacturers alike.[5] The various manufacturers held, among them, over nine hundred different patents. The

[1] 68 *Chron.* 974.

[2] 69 *Chron.* 177.

[3] A list of these manufacturers was published at the time. It may be found in 1900 *Moody's Manual of Corporations*, 296. Summary Statement, 68 *Chron.* 974.

[4] Net earnings of constituent plants as shown by audit of W. T. Simpson, published by Baring, Magoun & Co., and also restated in the George Pope affidavit, XIII *R. I. C.* 689. These figures were probably excessive, because inventories of "dead" stock were not charged off to profit and loss account.

1895	$5,118,958
1896	7,763,460
1897	3,708,867
1898	3,328,885

At time of combination, summer of 1899, the earnings for 1899, partly actual and partly estimated, were $3,983,684.

[5] Some of these economies of consolidation, aside from lessened waste in advertising, which the promoters believed would be realized were:

(*a*) Administration expenses.
(*b*) A single purchasing agent.
(*c*) Saving through large orders of raw materials.
(*d*) Standardization of parts requiring less expense in carrying supplies.
(*e*) Concentration of plants.

collective use of these patents might of itself be expected to promote efficiency and economy.

The American Bicycle Company was incorporated under New Jersey laws, May 12, 1899. Its authorized capitalization was \$80,000,000, of which \$35,000,000 was 7% preferred stock and \$45,000,000 was common stock. The Company was incorporated before any of the manufacturing plants were actually acquired. It was proposed at first to dispose of the stock through bankers and to pay for the bicycle plants with money. But as time passed, so many different consolidations made their appearance that it was decided to change the financial plan, so as to make the securities more attractive to the public. As a result of these changes, only \$9,300,000 of the preferred stock was issued and \$17,700,000 of the common stock, but in addition the Company authorized \$10,000,000 of twenty year 5% debenture bonds.[1] There was considerable delay in executing the several purchases and the plants were not formally transferred to the American Bicycle Company until September 22, 1899. At first, it was rumored that the new Company would acquire the plants by giving half cash and half stock.[2] In the end, Mr. Spalding paid for the plants by giving for each money or debenture bonds, taken at 92½%, to the amount of 30% of the appraised value of the plant, preferred stock to the amount of 30%, and common stock to the amount of 50%.[3] The manufacturers, in many cases, elected to take the debenture bonds instead of the cash. What money was required was supplied by an underwriting syndicate, headed by the United States Mortgage and Trust Company, of New York, and Lee, Higginson & Company, of Boston, which took over the bonds at 92½%.[4] Subsequently, \$6,300,000 of these debentures were offered the public by Baring, Magoun & Company.[5] This amount represented the bonds not taken by the manufacturers at 92½%, and the margin left over to the bankers and promoters. The plants

[1] A small part of the stock was not actually issued and was cancelled later.

[2] 68 *Chron.* 1021.

[3] XIII *R. I. C.* 689.

[4] 68 *Chron.* 974; XIII *R. I. C.* 689.

[5] 69 *Chron.* 696.

were appraised at approximately $10,000,000, and the net quick assets and inventories at approximately $12,000,000, — $22,000,000 in all.[1] On the basis of this appraisal Spalding issued $7,230,000 in debenture bonds, $6,700,000 in preferred stock, and a little over $11,000,000 in common stock of the American Bicycle Company. There remained to him as the promoter of the enterprise and for the payment of commissions approximately $2,000,000 in debentures $2,600,000 in preferred stock, and $6,700,000 in common stock.[2]

There seems no doubt that the "appraisal" represented an over-estimation of value at the time the plants were acquired. The American Bicycle Company, in its Massachusetts report, values the assets at $18,000,000. Even the inventories, which made up the bulk of the total quick assets, were excessive as it later developed, because much of the finished product was unsaleable. If we place a value of $14,000,000 on the entire property, — $5,000,000 for the plants and $4,000,000 for the inventories, and $5,000,000, for the cash and receivables, the estimate is not far from correct. Against the property was issued $36,000,000 in securities bearing fixed charges of $500,000 and fixed and contingent charges of $1,200,000.

[1] Assets stated at time bonds were offered to the public (September 30, 1899). Summary in 69 *Chron.* 696. Appraisal of real estate by American Appraisal Company of Milwaukee.

Real estate	$3,997,386
Machinery	5,884,625
Inventories	7,493,486
Receivables	5,631,715
Cash	1,176,533
	$24,183,745
Current liabilities	1,893,594
Assets	22,290,151

The balance sheet of the American Bicycle Company filed at the Massachusetts State House, as of October 1, 1899, approximates the above closely. The chief differences are liability items for $4,392,278, as reserve for depreciation and the floating debt stated as $2,503,902. The net assets in this case were exactly $18,000,000.

[2] Statement based on stock actually issued, omitting that afterward cancelled. It ought to be noted that after the promoter had paid the charges and commissions to the bankers, the attorneys and others, there remained only a small profit.

The defect in the financial plan of this consolidation lay in the presence of bonds. The bicycle combination was one of the very few consummated in 1899 which issued bonds. Yet the promoters believed themselves unmistakably conservative in their provisions for the future, as the constituent bicycle manufacturers were then, apparently, earning at the rate of well over $3,500,000, and their average profits for the preceding five years were well above this amount.[1] The bond interest called for less than $500,000, a year, — one-seventh the amount the promoters had reason to expect, without taking into consideration any of the economies due to combination. Even the fixed and contingent charges on the bonds and preferred stock required less than a third of the past average earnings. Nor were the earnings published and the securities issued with a view to perpetrating a fraud on the credulous public. On the contrary, the bicycle manufacturers themselves had the utmost confidence in the Company — so also did Lee, Higginson and Company. The manufacturers themselves took most of the securities. In fact, Col. Pope not only elected to take the debenture bonds for his portion of the money included in the option price, but also bought the bonds allotted to other manufacturers. After it became apparent that their hopes of a substantial success would not be realized, they held on to their stock. Col. Pope even advised the investment of the funds of dependent relatives in the American Bicycle Company's securities, so confident was he of the success of the Company.

Soon after the organization of the Company, the management closed eight plants, and sold the rubber tire plants to the Rubber Goods Manufacturing Company,[2] receiving in payment some cash, and approximately $1,150,000, in the preferred stock of

[1] *Infra*, p. 252.

The manufacturers were, at the time the Company was promoted, making and selling close to 800,000 bicycles. Had the Company made a net profit of one dollar on each bicycle the total profits would have been ample to meet the interest charges, — provided the sale of bicycles continued at the same rate.

[2] A consolidation of manufacturers of rubber garments, hose, tires, and a variety of rubber utensils. Formation, XIII *R. I. C.* 37. Company later absorbed by United States Rubber Company. Arrangements with American Bicycle Company, XIII *R. I. C.* 38; 69 *Chron.* 1015; 71 *Chron.* 391.

the Rubber Company, and $2,300,000 in its common stock. The American Bicycle Company then offered its stockholders the privilege of purchasing this stock on the basis of one share of preferred and one share of common stock for $140. By this means, the Bicycle Company was able to add approximately $1,610,000 to its net working capital. Subsequently, in order to simplify its organization, the officials of the Company caused to be incorporated the American Cycle Company, which took over the bicycle manufacturing plants, and the International Motor Company, which undertook the manufacture of automobiles. The American Bicycle Company then became merely a holding Company. All these changes were dictated by a wise and conservative business policy, looking toward a better organized and more economical management.

In the autumn of 1900, the American Bicycle Company made its first public statement for the operations of the first ten months of its history. After charging off $1,168,015, for depreciation, and allowing for nearly $200,000 expended in purchasing subsidiary bonds and mortgages, the bicycle consolidation showed net profits of over $850,000. Its finances were managed most conservatively. In the statement to the Listing Committee of the New York Stock Exchange, the Directors stated that the net quick assets, November 1, 1900, amounted to $11,854,836.[1] In the meantime, the Company had retired $500,000 of the debenture bonds.

The initial sales of the American Bicycle Company's securities, at the beginning of 1900, were on the basis of the following quotations: —

Debenture bonds about 94 %
Preferred stock about $55 a share
Common stock about $16 a share.

This indicated a market valuation of approximately $16,500,000 for the property of the Company. From these high prices of January, 1900, the securities of the Company fell rapidly in market value until, in December of that year, the bonds were sold at 70%, the preferred stock at $22, and the common stock at $5 a share. It is difficult to understand why the Bicycle

[1] New York Stock Exchange, Listing Application. Summary in 72 *Chron.* 534.

Company's securities were not more highly valued considering the liberal earnings of the subsidiary plants, and the strong management. Financially the Company was in a good position, and the signal defect of the whole consolidation, the paralysis of the bicycle industry, had hardly begun to make itself felt. After the securities were admitted to the list of the New York Stock Exchange, the prices for them improved somewhat, — the bonds 83%, and the preferred stock $33, — but the rally was of short duration.

In the autumn of 1901, the second annual report for the year ending July 31 of that year was made public. The report stated that only ten factories were in active operation as a result of the concentration of the manufacturing part of the business. The year had been an unfortunate one, on account of the bad weather during the spring months, when people most often purchased new bicycles. The annual profit, however, amounted to over $800,000, which was nearly twice the annual interest on the outstanding debentures. The total surplus earned, above interest charges, stood at $956,262.

In the spring of 1902, the securities of the Company rose slightly on the expectation of a prosperous summer demand for bicycles. Unfortunately this was not realized, and toward the end of the summer, rumors became current to the effect that the "Bicycle trust" was in difficulties. It was also stated that dissention had arisen in the management with reference to the advisability of meeting the semi-annual interest payment on the debenture bonds due September first.[1] On August 29, 1902, the market price of the bonds dropped abruptly from 62½% to 57%, on the refusal of the management to deny the truth of the rumor, and three days later the American Bicycle Company defaulted in the interest payments of the debenture bonds. On the announcement of the default, the bonds declined in price to about 45%, the preferred stock to $6 a share, and the common stock to $1 a share. It was rumored at the time, that the Treasury of the Company had on hand only $20,000, with

[1] "For some weeks past sinister reports have been in circulation regarding the financial status of the Company." *New York Herald*, August 30, 1902.

which to meet the bond interest of $225,000, notes of Baring, Magoun and Company, aggregating $150,000 and other notes of over $100,000. It later developed that the American Bicycle Company and its subsidiaries had debts, other than the debentures of the parent Company, of over $1,500,000.[1] Immediately after the default, application was made to the United States Circuit Court at Trenton, for the appointment of a receiver. Judge Kirkpatrick appointed Col. A. A. Pope and R. L. Coleman, former Chairman of the Board and President, and J. A. Miller, of Newark, as Receivers.[2] At the same time a self-constituted Reorganization Committee asked for the deposit of securities, in the interest of a speedy reorganization. Receivers' certificates to the amount of $500,000 were authorized in order to meet the claims for wages and merchandise, so that the Receivers could operate some of the plants.[3] The stocks of two of the subsidiaries were pledged as security for the Certificates,[4] which were immediately bought by friends of the Company.[5]

At the time of the default on the interest of the Company's debenture bonds, it was announced, as usual in such cases, that the financial difficulties of the American Bicycle Company arose from a lack of working capital, and were thus of a temporary nature. "The Company has always been hampered by lack of working capital."[6] This was obviously not strictly true. When the Company commenced business, its official statement showed that its cash alone amounted to over $1,000,000, and its receivables, — not counting the inventory, — to over $5,000,000, while the current liabilities were less than $2,000,000. Sub-

[1] Examination by Audit Company of New York made for Reorganization Committee. Plan and Agreement of Reorganization dated December 15, 1902, p. 3. Outline in 75 *Chron.* 1304, 1402.

[2] 75 *Chron.* 499.

[3] 78 *Chron.* 853.

[4] Reorganization Plan, December 15, 1902, p. 2.

[5] 75 *Chron.* 1033.

[6] 75 *Chron.* 499.

"The moving reason for this course (the appointment of Receivers and reorganization) is that the Company is, and has been since its organization, hampered by lack of working capital. . . . The Company is perfectly solvent and undoubtedly has an assured future. It controls about seventy per cent of the bicycle output." Statement published by Company, September 2, 1902.

sequently the Company realized over $1,500,000 in cash from the transfer of its tire interests to the Rubber Goods Manufacturing Company. From the point of view of its balance sheets, the American Bicycle Company appeared particularly strong in its net working capital.

The real reason for the failure of the consolidation lay much deeper. The bicycle business had suddenly collapsed. In 1899, the year the consolidation was consummated, the constituent plants manufactured and sold approximately 860,000 bicycles. In 1902, the output of the American Bicycle Company was, so far as can be gathered from indirect evidence, about 100,000 machines. Beginning in 1897, the output of the manufacturers had exceeded the demand. At first they sought to dispose of this surplus by exporting it to foreign countries, but the stocks that accumulated in the foreign warehouses were total losses to the Company.[1] Even at the very outset, the Company's accounts showed the large net quick assets only by including in the inventories accumulated stocks of bicycles which, under the conditions of trade then prevailing, should have been regarded as dead. The officers of the Company at the time of the receivership emphasized the fact that the Company controlled 70% of the bicycle trade. But a virtual monopoly would have been hardly more encouraging. No clearer example exists, in the economic history of the country, of the truth that the value of capital rests in its earning power, and not in its "cost," and furthermore, that earning power derives its value from social needs evidenced by social demand.

The Reorganization Committee, consisting of interests associated with the Company,[2] announced a plan of reorganization. A new Company was to be formed which should acquire the assets of the American Bicycle Company through foreclosure

[1] Certain invoices to Liverpool resulted in a total loss, — the amount ultimately obtained for the bicycles being hardly sufficient to pay the freight and storage. One large shipment to Australia failed to meet the expenses and the Company had a debit balance with the consignee.

[2] William A Read (*Chairman*).

Fred P. Olcott,	Colgate Hoyt,
George F. Crane,	F. S. Smithers.

sale. A voting trust for the stock was to be created. The debenture bonds were to be extinguished, and the holders were to receive second preferred stock in the new company, at par without assessment.[1] At first, it was proposed to allow this second preferred stock 6% non-cumulative dividend, but later the dividend rate was changed to 5% and made cumulative after February 1, 1905.[2] The preferred and common stocks were each assessed nine dollars a share, and given first preferred 6% cumulative stock to the value of their assessment. In addition, the old preferred stock received 50% in new common stock, and the old common stock 25% in new common stock. The plan can be seen from the table given on the next page.

The most serious criticism that can be mentioned is in the unfairness with which the preferred stockholders were treated, in comparison with the common stockholders. At the time of consolidation, and even after the American Bicycle Company was on its feet, the officers contended that the preferred stock was represented by tangible assets, and it had been absorbed by the outside public to some extent as an investment security.[3] This being the case, the purchasers of the preferred shares would consider themselves in a distinctly stronger position than the holders of the common stock. Yet the only difference in the reorganization plan was that, after paying the same assessment, the preferred stockholder received twice as much of the new common stock as the holder of the common stock. This apparent disadvantage of the preferred shareholder was all the more unfortunate because the preferred was more in the hands of the public than the common stock.[4]

The plan of reorganization avoided the creation of bonds. Like the first Reorganization of the National Cordage Company, the American Bicycle Reorganization refunded the previously existing bonds into a preferred stock. It went even further.

[1] Reorganization Agreement, December 15, 1902, pp. 5, 6.

[2] Modification of Agreement dated January 26, 1903, p. 2.

[3] Affidavit of George Pope. XIII *R. I. C.* 689.

[4] From personal evidence given to present writer. Shown also by large sales of preferred stock on the New York Stock Exchange.

	AMERICAN BICYCLE COMPANY					POPE MANUFACTURING COMPANY							
	Bonds	Fixed Charges	Preferred Stock	Contingent Charges	Common Stock	Cash Assessment		First Preferred Stock	Second Preferred Stock		Contingent Charges	Common Stock	
						Single	Aggregate	Aggregate	Single	Aggregate		Single	Aggregate
Debenture Bonds	$9,150,000	$457,500	. .	.	....	.	.	.	100%	$9,150,000	$457,500		
Preferred Stock	....	....	$9,294,900	$650,643	.. .	9%	$836,541	$836,541	. ..	....	50,192	50%	$4,647,450
Common Stock	....	.	.	. .	$17,701,500	9%	1,593,135	1,593,135	. .	. .	95,588	25%	4,425,375
Totals	$9,150,000	$457,500	$9,294,900	$650,643	$17,701,500	....	$2,429,676	$2,429,676	. .	$9,150,000	$603,280	.. .	$9,072,825

FLOATING DEBT $1,506,608 $90,396

SUMMARY	Old	New	Change: Amount	Change: Percentage New to Old
Securities bearing Interest	$9,150,000	....	−$9,150,000	
Liabilities bearing Interest	10,656,608	. .	−10,656,608	
Securities bearing Fixed and Contingent Charges	18,444,900	$11,579,676	− 6,865,224	63%
Total Securities	36,146,400	20,652,501	−15,493,899	57%
Total Liabilities	37,653,008	19,729,433 [1]	−17,923,575	52%
Fixed Charges	457,500	. ..	− 457,500	
Current and Fixed Interest Charges	547,896	..	− 547,896	
Fixed Current and Contingent Charges	1,198,539	548,000 [2]	− 650,539	46%
Fixed and Contingent Charges	1,108,143	603,280	− 504,863	55%

[1] After deducting the net new money.

[2] After deducting interest on new money.

It retired the floating debt by means of a money assessment, which was represented among the securities of the reorganized Company by stock rather than bonds. The total floating debt amounted to $1,506,608 on November 1, 1902.[1] This, with the debenture bonds, made a total debt of nearly $11,000,000. The entire amount was refunded into stock by the reorganization, and in addition, nearly $1,000,000 was placed in the treasury. Total debt and stock liabilities of $37,653,008 were thus reduced to less than $20,000,000, — after allowing for the new money, — and this was entirely stock.

Soon after the announcement of the plan, a Committee of the public holders of the debenture bonds sprang up which solicited the coöperation of those dissatisfied with the plan.[2] Little was accomplished, however, probably because of the relatively slight pecuniary interest of the public in the Bicycle Company's securities. By the middle of January, 1903, hardly a month after the announcement of the plan, it was declared operative. In due course of time, the Pope Manufacturing Company was incorporated under New Jersey laws, and the personal property of the old American Bicycle Company and the shares of the subsidiary companies were bid in by the Reorganization Committee for $3,500,000.[3] The syndicate which underwrote the assessments for the common and the preferred stocks was called upon to take up nearly a fifth of the old stock, showing that a considerable number of the public stockholders allowed their interest in the new Company to lapse by default. With but slight interruption, the entire reorganization was consummated without difficulty and the new Pope Manufacturing Company began doing business in its own name August 1, 1904. In this new Company the Pope family was dominant. Col. Pope had had confidence in the old Bicycle Company, and had kept his

[1] Plan and Agreement of Reorganization, December 15, 1902, p. 9.

[2] Edwin Gould, H. L. Higginson, W. H. Taylor, Wm. M. Laws, Sec. Brief notice in 76 *Chron.* 49, 267. The influence of this committee was sufficient, however, to accomplish the change from the 6 % non-cumulative rate on the preferred stock, into which the bonds were to be refunded, to the 5 % rate cumulative after two years.

[3] Acceptance of offer authorized by Judge Kirkpatrick, April 27, 1903.

securities through the reorganization. In the new Company, he was personally the largest holder of the second preferred stock. He was also the "owner of nearly all the common stock." [1]

The first year of the Pope Manufacturing Company was not financially successful. Gross sales of over $7,000,000 resulted in a net profit of $50,000. [2] Clearly the dividend on the first preferred stock was not earned. The second year showed little, if any, improvement. When the sudden cessation of demand for bicycles was fully realized, the managers turned toward the manufacture of automobiles. The latter industry was in its infancy, other manufacturers were already better established, and the cost of refitting the factories laid a new burden on the already over-burdened finances of the Company. One after another of the old bicycle Company's plants were disposed of, but the Company was in constant need of working capital. Toward the close of 1904, the first preferred stock had a market value of about $89 a share, the second preferred stock, — the old debenture bonds of the Bicycle Company which Baring, Magoun and Company had sold to the public at par, — a value of about $16 a share, and the common stock of about $5 a share.

Little of consequence occurred in the history of the Pope Manufacturing Company until the summer of 1907. The bicycle business was concentrated in two factories, and an advertising campaign was inaugurated to introduce the Pope-Tribune, and the Pope-Hartford automobiles. By the end of 1906, the net surplus amounted to a little over $90,000, but it is difficult to say how much of this should have been charged to depreciation account. The public presumed that the Company was doing fairly well, and that no serious crisis was impending. It was with surprise, therefore, that the business world learned, on August 17, 1907, that Receivers had been appointed on the petition of a merchandise creditor. The failure of the Pope Company was among the first serious embarrassments of the panic of 1907, and the fact that it occurred in the summer, at the first signs of money stringency, indicated the precarious condition of the Company. Its financial difficulties were serious. The

[1] 78 *Chron.* 1966.

[2] 80 *Chron.* 115.

underlying cause was the difficulty of readjustment entailed in changing from the bicycle to the automobile business. At the time of the first reorganization, it was supposed that much of the machinery used in the manufacture of bicycles could be taken over by the new Company at a fair valuation. This assumption proved unwarranted, as the economical manufacture of the automobile required new and special machinery. Much of the working capital obtained at the earlier reorganization had to be used for refitting the factories, and the old machinery, carried at large values on the books of the Company, proved of little service in the actual operation. The inventories, consisting mostly of bicycles and bicycle parts had proved little else than a burden.

Until a settlement could be effected the business was conducted by the Receivers, A. L. Pope, the former Vice-President, and E. J. Tamblyn. In the meantime the prices of the Company's shares fell. The first preferred stock which represented money paid in at the time of the American Bicycle Company's Reorganization was quoted at $15 a share. The second preferred stock, which represented the debenture bonds of the American Bicycle Company taken by the United States and Mortgage and Trust Company and by Lee, Higginson and Company at 92½% and offered to the public by Baring, Magoun and Company at par, was quoted at one dollar a share. The common stock, which represented the old preferred and common stock of the American Bicycle Company, was quoted nominally at one-eighth of a dollar a share,— twelve and a half cents. The market value of the Pope Manufacturing Company on the basis of these quotations amounted to $457,401, or about one-fifth what the stockholders had contributed in money at the time of the American Bicycle Company's Reorganization. This $457,401 was the market value of stocks having par value of $21,000,000, and representing assets carried on the books at over $23,000,000. In 1900 the corresponding securities of the old American Bicycle Company had a total market value of $16,500,000. Taking into account the money contributed at the time of the American Bicycle Company's Reorganization, property once of a

market value of $19,000,000 had declined to less than three per cent.[1]

The problem involved in the successful reorganization of the Pope Manufacturing Company was the liquidation of the floating debt.[2] This could not be easily accomplished until the force of the panic of 1907 had spent itself. It could be done finally only through the further investment of new money, and this required an easier note market than prevailed during 1907. The officers of the Company, therefore, wisely postponed any settlement of the difficulties until the autumn of 1908. In the meantime they secured the coöperation of certain friends and bankers who consented to advance $800,000 on short term notes in consideration of a bonus of $500,000 in new preferred stock voting trust certificates and $90,450 in new common stock voting trust certificates.[3] The syndicate thus consututed then offered the notes to the old stockholders giving with each note a bonus of 50% of new preferred stock voting trust certificates. Had the stockholders later subscribed to the entire amount of the notes the syndicate commission would have amounted to $100,000 in the preferred and $90,450 in the common stock.[4]

The final syndicate and reorganization agreement was dated July 15, 1908. No assessment on the old stockholders was contemplated. Their holdings were, however, to be cut down considerably and the common stock was to be obliterated altogether. Yet considering that the common stock possessed merely a nominal market value of twelve cents a share, the sacrifice could

[1] This market valuation was distinctly less than the actual worth of the Pope Manufacturing Company's assets. For example, the land and buildings at Hartford were inventoried at $573,450 (*Hartford Times*, September 16, 1907), and this figure was distinctly conservative in view of the reproduction cost. In addition the Company had its machinery, tools, and a probable balance of net quick assets, although the forthcoming panic of the autumn of 1907 made any judgment of the value of quick assets somewhat doubtful.

[2] List of liabilities aggregating $1,008,542.33 filed August 31, 1907, Superior Court, Connecticut.

[3] Reorganization Agreement, July 15, 1908, p. 7.

[4] This somewhat original, but on the whole, wise plan was devised by Albert Rathbone, Esq., of Joline, Larkin and Rathbone. Had the trouble been precipitated by any other cause than a stringency in the money market, it is doubtful if it could have been relieved by a mere palliative.

not be considered great. Most of the common stock, together with a majority of the second preferred stock, was held in the family of Col. A. A. Pope so that the reorganization bore hardest on those close to the management. The Pope Manufacturing Company of Connecticut was organized to take over the assets of the old Company of New Jersey. Its capital stock was $2,500,000 in first preferred 6% cumulative stock, and $4,000,000, in common stock. The first preferred stockholders were allowed 75% of their holdings in new preferred stock and 83% in new common stock.[1] This liberal allotment was due to the fact that the first preferred stock had a claim to dividends that had been accumulating since the last reorganization at the rate of 6% a year. In case the business was wound up, the first preferred stock would receive not only its par value, but also its accumulated unpaid dividends. It was a distinct question whether or not, at forced sale, the Company had assets sufficient to meet these claims of the first preferred stockholders in full. The second preferred stockholders received 20% in new common stock. The table given on the next page summarizes the financial plan of the reorganization. From this table it is clear that both the capitalization and nominal contingent charges were reduced considerably. Other than these changes in the form of capitalization, little except temporary relief was accomplished. No permanent new capital was added. The men who furnished sufficient money to fund about half the floating debt into short term notes were given over $500,000 in stock. It was the price which the Company felt itself compelled to pay that it might be able to continue in operation. Like the Westinghouse Company at the time of its second failure, the Company faced a financial panic with an unmanageable floating debt, and relief was possible only through the application of some paliative. But, unlike the Westinghouse Company, the Pope Company obtained the necessary relief by means of a loan, which gave no permanent addition to the resources of the Company.

After this Reorganization was consummated, the new Pope Manufacturing Company of Connecticut paid off the syndicate

[1] Reorganization Agreement, July 15, 1908, p. 6.

POPE MANUFACTURING COMPANY OF NEW JERSEY — POPE MANUFACTURING COMPANY OF CONNECTICUT

	Preferred Stock	Contingent Charges	Common Stock	Funded Debt	Fixed Charges	Preferred Stock		Contingent Charges	Common Stock	
						Single	Aggregate		Single	Aggregate
First Preferred Stock	$2,391,000	$143,460	....	. ..	....	75%	$1,793,250	$107,595	83%	$1,984,530
Second Preferred Stock	8,625,100	431,255	....	....	. .	....	.. .	....	20%	1,725,020
Common Stock	....	. ..	$10,000,000							
Syndicate Subscribers	....	. ..	....	$800,000	$48,000	....	400,000	24,000		
Syndicate Commission	....	. .	...	.	. ..	.. .	100,000	6,000	.	90,450
Totals	$11,016,100	$574,715	$10,000,000	$800,000	$48,000	. ..	$2,293,250	$137,595	..	$3,800,000
FLOATING DEBT	$1,640,000		$98,400	$840,000		$50,400				

SUMMARY	Old	New	Change Amount	Percentage New to Old
Securities bearing Interest	. .	$800,000	+ $800,000	.... .
Liabilities bearing Interest	$1,640,000	1,640,000	....	100%
Securities bearing Fixed and Contingent Charges	11,016,100	3,093,250	− 7,922,850	28%
Total Securities	21,016,100	6,893,250	−14,122,850	33%
Total Liabilities	22,656,000	7,733,250	−14,922,750	34%
Fixed Charges	....	48,000	48,000	.....
Current and Fixed Interest Charges	98,400	98,400	....	100%
Fixed, Current, and Contingent Charges	673,115	235,995	− 437,120	34%
Fixed and Contingent Charges	574,715	185,595	− 389,120	32%

loans in rapid succession; and during the next four years the Company was in a fairly prosperous condition. But in 1913, owing to an unsuccessful attempt to manufacture low priced automobiles, the Company failed a third time. As this proof is being corrected for the press (December, 1913) the preferred stock is quoted at $8 a share and the common stock at $1 a share. A part of this common stock is all that remains of the original bonds sold in 1899 by reputable bankers to the public at par. Had a private investor purchased a $1,000 bond of Baring, Magoun & Co. in 1899 he would have, after the changes necessitated by the operation of the reorganizations of 1903 and 1908, two shares of common stock. In addition he would have lost interest for twelve years. In brief, having bought the underlying bond of an industrial consolidation in 1899, recommended by reputable investment bankers in Boston and New York and secured by actual tangible property costing at least twice the total bond issue, a private investor would have in 1913 an investment worth two dollars. Including simple interest this stock would represent an investment of $1,600.

The failure of the American Bicycle Company is a conspicuous instance of the collapse of a financial structure, following the collapse of an industry. People ceased using bicycles, and the corporation that held a practical monopoly in their manufacture found the demand for its product had fallen below the point where it could employ methods of large-scale production. The capital invested in the manufacture of bicycles ceased to fulfill an economic and social service and the Company failed. A reorganization of the most drastic character could not rehabilitate either the industry or the corporation. A more striking failure would be difficult to discover in the annals of our consolidation movement. The causes lay primarily not in inefficient management or unwise financial policy, but in the practical cessation of a manufacturing industry employing machinery not readily readjusted to other uses.

CHAPTER XI

THE AMERICAN MALTING COMPANY

Nature of the malting business, 270; promotion of the American Malting Company, 271; incorporation of American Malting Company, 275; value of the property acquired, 277; purchase of the Neidlinger plants, 280; early success, 283; methods of accounting, 283; the inflation of net income, 286; distress of the Company, 289; litigation covering promoters' profits and dividends declared out of capital, 291; primary causes of failure of Company, 294; the two unsuccessful plans of reorganization, 296; reorganization of American Malting Company and formation of the American Malt Corporation, 301; conclusion, 304.

CHRONOLOGICAL SUMMARY

1896. First plan of consolidation.
1897. Promotion of the American Malting Company.
1899. Purchase of the Neidlinger malt houses.
1900. Beginning of litigation.
1903. Two unsuccessful plans of reorganization and an attempt to change the management.
1905. Settlement of litigation.
Successful reorganization.
1906. Incorporation of American Malt Corporation.

FROM the point of view of this book, the interest in the American Malting Company centers about three periods in its financial history, — the promotion, the early declaration of dividends out of capital, and the final successful reorganization. The American Malting Company was one of the lesser industrial consolidations. There was nothing unusual in the economic conditions which led to its promotion, and its failure was due primarily to the fact that the consolidated company did not make the profits its promoters had anticipated. Competition did not cease after the formation of the consolidation, while the personal interest of the manufacturers in the business did. In these respects, the malting combination differed but little from others which came into existence during the same period of promotion, and it would call for no special comment were it not for the fact that, from the point of view of financial history, certain features connected with its reorganization are of more

than ordinary interest. In the course of extended litigation, the validity of promoters' secret profits came under the review of the courts, and the declaration of dividends out of capital was definitely condemned. The final reorganization grew out of a confession of weakness due to over-capitalization and bad management, coupled with a sincere desire to rehabilitate the finances of the corporation through the adoption of a more conservative policy. The importance of the questions of corporation finance involved gives a much greater significance to the history of the malting combination than the size of the business would warrant.

Malt is germinated grain. In the process of germination, the starch is transformed by diastase into sugars and dextrines. Barley grain is the basis of the best malt. Oats, rye, and even corn are sometimes used on account of their lower price, but for the majority of uses these substitutes are not as good as barley malt. There are three methods by which the grain is malted. In the old "floor" system the grain is steeped for a few days to start the germination. It is then conveyed to large open floors, where it is turned by hand shovels, until the starch has been converted. In the "drum" system, the grain is germinated in large drums that revolve continuously in order to keep the grain loose, and at an even temperature. In the "compartment" system, the grain is passed from the steep tanks into large compartments where it is kept in motion by endless spirals. The "floor" system is antiquated; it can be used during only a comparatively brief season of the year, because the maltster cannot control the temperature. Malt houses constructed on one of the other two systems can be used the year round, the labor costs are less, but the initial capital expenditure is much greater than in the old "floor" system.[1]

[1] No floor system malt houses are being erected now. An engineer familiar with costs estimated the net cost of production, taking into consideration the periods of operation, of the floor system at 14 cents a bushel of malt; the improved drum system, 5½ cents; the compartment system, 4½ cents. These figures are merely rough approximations which are bound to vary according to individual conditions. They are of significance, however, in the following narrative because the majority of the malt houses taken over by the American Malting Company were constructed on the floor system.

Malt has a variety of uses, — in the preparation of yeast, and in patent cereal foods, for instance, — but its chief use is in the brewing of beer, ales and porter. As most of the malt manufactured is bought by the brewers, malt may be regarded as a semi-manufactured product, a half-way step in the production of a commodity, finally taken by the ultimate consumer. The margin between the market price of barley and that of malt represents the gross profit to the maltster out of which he must defray the expenses of manufacture. The net profit remaining is relatively small, averaging about five cents a bushel of grain during a period of ten years, but owing to the fluctuations in the market of both barley and malt the net profit at any one time may be changed easily to a loss. The only advantage one maltster has over another, except for skill and foresight of management, is in friendly relations with the brewers. This factor was of great importance some years ago, but with the improvements in the methods of manufacture and distribution, friendships and family connections count for much less than they did. Large capital is not required. A malt house of most improved design and construction with a capacity of 150,000 bushels can be built for about $100,000.[1] From these few facts, it is obvious that we are dealing here with a normal manufacturing business in which the conditions foster the keenest kind of competition. The general circumstances of success or failure, under which numerous competing units in a stable industry such as this are brought into a single consolidation, are worthy of a careful and a somewhat detailed study.

In the period directly after the panic of 1893, competition among the maltsters was very severe, and the element of friend-

[1] Earlier in the history of the brewing industry it was not uncommon for the brewer to prepare his own malt. Malting and brewing are now conducted as separate businesses, in the large majority of cases, for the following reasons: (1) the price of barley is very speculative and the purchase requires expert knowledge not usually possessed by the brewer. (2) A malt house is most favorably located near one of the primary grain markets, whereas the brewery, especially the small one, is best located near the points of consumption. (3) The malt house of the most economical size produces more malt than the ordinary brewery can use. (4) It is a distinctly different business and requires different technical knowledge.

ship played a conspicuous part in business dealings.[1] Little or no malt could be sold without great effort. As a result it was natural for the maltsters to search for some way of reducing the severity of competition. In the spring of 1896, Seymour Scott, a small maltster of Lyons, N. Y., suggested a consolidation in the malting industry which should include some of the better known malt houses.[2] Adam Neidlinger, the head of the malt house of Neidlinger and Sons, the largest in the country, refused to enter the proposed consolidation, and the plan was allowed to lapse temporarily. Scott, however, entered into negotiations with other maltsters, many of whom, especially those owning dilapidated "floor" system houses, welcomed the plan of disposing of their property to a "trust." He had the active coöperation of Charles M. Warner, a shrewd capitalist, who anticipated making secret profits through the promotion. As a result of these negotiations, Scott and Warner were able to secure the options on something over twenty malt houses, situated in various parts of the country, and with these in hand, Scott sought the assistance of New York bankers. Mr. E. R. Chapman, of the banking house of Moore and Schley, and Mr. Koster, of J. P. Morgan & Company, undertook to investigate the merits of the enterprise. At that time promotions were popular, and they anticipated no difficulty in disposing of the securities once they had been convinced that a consolidation of malt houses could be established on a remunerative basis. To ascertain this fact, they employed a well-known accountant, Edward L. Suffern, to make an examination of the books of the selling maltsters. As his reports, together with the opinions of Messrs. Chapman and Koster, proved satisfactory, Moore and Schley, J. P. Morgan & Company,

[1] Competition was so strong that the maltsters could only hold their trade through personal friendship For illustration, the largest maltster in the east kept an index in which were registered the names, addresses, birthdays, wedding days, etc., of all the brewers with whom he had dealings and their relatives. Remembrance cards and presents were regularly sent out. The maltster had to be in constant attendance at the social functions given by the brewers.

[2] The idea was suggested in the most casual fashion to George Neidlinger of Neidlinger and Sons, New York, during a conversation held while crossing Boston Common.

and the Guaranty Trust Company decided to proceed with the promotion of the consolidation.

The options were transferred to the name of Casper H. Eicks, an employee in the office of Moore and Schley. These options covered the properties of some twenty-two malt houses widely distributed from Wisconsin to New York.[1] With some, or all, of these options in hand, Moore and Schley solicited subscriptions to the stock of the American Malting Company, as yet unincorporated. It was planned that this corporation, when formed, should take over the options and pay for the plants. Public subscribers were offered the preferred stock at par, with a bonus of 50% in common stock,[2] and the public bought $9,-000,000 of the preferred stock on these terms. It was represented by the promoters, fortified by estimates furnished by Edward L. Suffern, and by the estimates of certain maltsters, that the "net earnings of these properties would be at least $2,000,000 annually, without raising the price of the product to the consumer."[3] The estimate given in the *Financial and Commercial Chronicle* was even more optimistic. "Expert accountants, after examination, have certified that during the past five years of depression, these concerns earned net about $1,300,000 per annum, on a competitive basis.[4] It is the opinion of the ablest men in the trade that the net earnings, by reason of the reductions in the cost of administration, etc., can be increased at least $1,000,000."[5] Before the American Malting Company was incorporated, the enterprise was spoken well of in financial circles, and the selling maltsters themselves agreed to

[1] The location, relative size, and type of the houses may be seen at a glance from the table on the following page.

[2] Original subscription blank, dated September 27, 1897.

[3] Minutes of the first meeting of Board of Directors of the American Malting Company, September 28, 1897.

[4] Mr. Suffern's estimate was based on a very hasty examination of the plants, yet there is no doubt but that the malt houses entering the combination were, as a whole, on a paying basis. The estimate can be considered thoroughly reliable. The present example, in the light of subsequent history, is a startling illustration of the fallacy of basing an estimate of the future earnings of a consolidated Company upon the aggregate earnings of the constituent plants prior to their combination.

[5] 65 *Chron.* 619.

Plant	Location	Capacity Bushels	Family in Control	System of Malt Manufacture
L. I. Aaron Malting Co.	Chicago, Ill.	425,000	Aaron family	Floor
Fred F. Bullen Malting Co.	Chicago, Ill.	1,275,000	F. Bullen	Floor
Wm. Buchheit Malting Co.	Watertown, Minn.	900,000	Buchheit and F. Uhlmann	Compartment[2]
Brand, Bullen & Lund Malting Co.	Chicago, Ill.	365,000	Brand, Bullen, and Lund	Compartment[2]
Chicago Pneumatic Malting Co.	Chicago, Ill.	365,000	....	Compartment[3]
John Carden, Jr., Malting Co.	Chicago, Ill.	350,000	John Carden, Jr.	Floor
Estate of C. S. Curtis	Chicago, Ill.	1,000,000	Curtis family	Floor
Hansen Hop & Malt Co.	Milwaukee, Wis.	1,500,000	Hansen family	Floor
Carden Malting Co.	Chicago, Ill.	400,000	Carden family	Floor
Hales & Curtis Malting Co.	Chicago, Ill.	750,000	B. F. Hales	Floor
Howard Northwood Malt Mfg. Co.	Detroit, Mich.	500,000	Northwood family	Floor
Kraus-Merkel Malt Co.	Milwaukee, Wis.	1,800,000	F. Kraus, R. Nunnemacher, and some brewers	Drum
Milwaukee Malt and Grain Co.[1]	Milwaukee, Wis.	800,000	Asmuth, Manegold, Fink	Floor
Mathews Malting Co.	Le Roy, N.Y.	700,000	C. M. Warner	Floor
New York & Brooklyn Malting Co.	New York, N.Y.	100,000	H. Altenbrand	Floor
W. H. Purcell Malting Co.[1]	Chicago, Ill.	1,000,000	C. Purcell	Drum
Sohnger Malting Co.	Hamilton, Ohio	700,000	Charles Sohnger	Floor
Chas. A. Stadler Malting Co.	New York, N.Y.	350,000	C A. Stadler	Floor
C. M. Warner Malt Co.	Syracuse and Jordan, N.Y.	1,000,000	C. M. Warner	Compartment[3]
J. Weil Malting Co.	Chicago, Ill.	300,000	J. Weil	Floor
Estate of Jacob Weschler	Erie, Pa.	800,000	....	Floor
Later Taken In				
Southern Malt Co.	Clyde, N.Y.	These and the two following small houses produced about 300,000 bushels	C. M. Warner	Floor
Clyde Malt Co.	Clyde, N.Y.		C. M. Warner	Floor
Weedsport Malt Co.	Weedsport, N.Y.		C. M. Warner	Floor
John M. Moser Malt Co.	Lockport, N.Y.	Small house	J. M. Moser	Floor
Scott Malt Co.	Lyons, N.Y.	Small house	S. Scott	Floor
Neidlinger & Sons	New York, Brooklyn, N.Y.	2,000,000 bushels	Neidlinger family	Floor

[1] Plants never operated by American Malting Company. [2] Saladin system. [3] Dornfeld system.

take $3,000,000 of the preferred stock, with a bonus of 50% in common stock in partial payment for their plants. Judging from the valuations of the malt houses, the probability seems to be that this preferred stock was taken by the maltsters instead of money, the terms being somewhat more favorable than those offered the public.

On the strength of the options, and the successful public offering of the stock of the prospective Company, Moore and Schley employed the attorneys Simpson, Thatcher, and Barnum to form the Company. It was to be a New Jersey corporation. The certificates were filed, September 28th, by H. H. Durand, J. J. Treacy, and Frederick Dwight, employees in the office of the attorneys. The certificate called for a capitalization of $30,000,000, divided equally between 7% cumulative preferred, and common stock. All but $2,500,000 of preferred stock and $1,125,000 of common was to be issued in the first instance. The first President was H. H. Durand, the attorney's clerk, and the first Treasurer, William M. Barnum. There were, beside the President, four "dummy" directors. At the first meeting of the Board, held September 28, 1897, the Directors entered into an agreement with Eicks to issue to the latter $12,500,000 in preferred stock and $13,750,000 in common stock.[1] In return for this, Eicks agreed to deliver to the new Company the twenty-two odd malting plants, for which he held options, and $2,080,000 in money to serve as working capital.[2]

At the time the Directors passed the resolution, "that, in the judgment of the Board of Directors of this Company, the value to this Company of the properties covered by the proposal of Mr. C. H. Eicks made this day is such as to justify and render desirable the purchase thereof by said Company, upon terms of his said proposal."[3] This resolution was passed to comply with the New Jersey statute that, "in the absence of actual fraud

[1] One hundred shares of this ($10,000) had already been issued to start the Company. The actual contract, therefore, called for only 137,400 shares ($13-740,000).

[2] $10,000 had already been paid, as stated in preceding note.

[3] Minutes of first meeting of the Directors American Malting Company, September 28, 1897, Resolution 1.

in the transaction, the judgment of the directors as to the value of the property purchased shall be conclusive." Considering, however, that none of the Directors were conversant in the least with the worth of the malting plants, and that the President of the Board was an irresponsible clerk of the attorney, their resolution can be regarded as expressing little more than the formal compliance with a much abused statutory provision. The $12,500,000 of preferred stock and $13,750,000 of common stock issued to Eicks was then assigned by him to the Guaranty Trust Company, which had been requested by Moore and Schley to act as their agents [1] for the issue of the securities of the American Malting Company. The Trust Company, having called for and received payment from the public of the original subscription of $9,000,000, now proceeded to issue their interim certificates for both the $9,000,000 in money subscribed by the public, and the $3,000,000 subscribed by the selling maltsters. Certificates for the bonus of common stock were delivered in both cases, in accordance with the terms of the subscription contract.[2]

The allotment to the subscribers, both the public and the maltsters, amounted to $12,000,000 of the preferred and $6,000,000 of the common stock. There was delivered by Eicks to the Trust Company $12,500,000 of the preferred and $13,750,000 of common stock. There remained, therefore, in the hands of the Trust Company $500,000 of the preferred stock and $7,750,000 of common stock. Eicks, at the request of Moore and Schley, now ordered the Trust Company to make this over to himself, and Moore and Schley.[3] This was the profit of the promoters after the payment of the expenses incidental to the

[1] Letter of Moore and Schley to Guaranty Trust Company, September 27, 1897.

[2] According to letter of Moore and Schley to Guaranty Trust Company of September 29, 1897, the selling maltsters were not to receive certificates of stock in the first instance, but only " certificates assuring the delivery," so that " such stock may not get into circulation." It has been very common for the promoters of industrial enterprises to insert some such clause, so as to prevent certain of the vendors or underwriters from realizing on their stock as soon as a market has been created.

[3] Letter of Eicks to Guaranty Trust Company of October 4, 1897.

incorporation. Moore and Schley immediately sold for their own account 4,000 shares of the preferred and 2,000 shares of the common stock.[1] The distribution of the stock can be seen from the following table.

	Preferred Stock Par Value	Common Stock Par Value
Issued to acquire in the first instance twenty-two malting plants and $2,080,000 working capital	$12,500,000	$13,750,000
Reserved in treasury	2,500,000	1,250,000
Authorized Capitalization	$15,000,000	$15,000,000

The amounts of the two classes of stock that were actually issued were accounted for as follows:

	Preferred Stock Par Value	Common Stock Par Value
Public subscription for $9,000,000 cash	$ 9,000,000	$ 4,500,000
Maltsters' subscription and as part purchase money	3,000,000	1,500,000
Promoters' share, including profits, underwriting fees, and expenses of incorporation	500,000	7,750,000
Total Issued Capitalization	$12,500,000	$13,750,000

The actual value of the properties conveyed to the Company can be estimated only indirectly. None of the maltsters sold their barley and malt on hand nor their bills receivable to the new Company. They conveyed only their plants and good-will. We are concerned, therefore, in the promotion, with merely the real estate value of the malt houses. The good-will of the concerns was of nominal value, unless the old maltsters remained in the actual management of their businesses. These malt houses had a remunerative capacity of something less than 11,000,000 bushels of malt annually, although their nominal capacity was assumed to be in excess of 16,000,000 bushels of malt a year.[2] Engineers estimate the cost of constructing

[1] Letter of Moore and Schley to Guaranty Trust Company, October 6, 1897.

[2] From October, 1897, to October, 1898, the Company actually bought and manufactured 12,253,659 bushels of malt. It started with 3,812,208 bushels bought from the selling maltsters. The actual manufacturing capacity of the Company during the first year of its history was, therefore, 8,441,451 bushels of malt. In the course of the year the Company actually sold 10,973,070 bushels of malt. During part of the time it was operating plants bought after the original promotion. (Figures computed from affidavit of Clark, an accountant. See

malt houses, including sites, at about $500,000 or $600,000 per million bushels capacity.[1] New plants of about the same productive power could then have been constructed for less than $6,000,000. A few years later, when the American Malting Company wished to issue $4,000,000 of bonds, it was stated that their plants, including certain properties acquired in the meantime for over $2,000,000, were worth in excess of $5,000,000.[2] Some of the malt houses originally acquired were soon abandoned. Two, at least, were never operated. If from these various lines of evidence, we estimate the value of the twenty-two malt houses at not over $5,000,000, we are placing upon them at least a liberal valuation.[3] The underwriting syndicate furnished $2,000,000 in money. The actual property received by the Company is, therefore, to be valued at not over $7,000,000. For this, the public and the maltsters subscribing to the promoting syndicates paid $12,000,000 in money; and the Company

Hutchinson and others *v.* Curtiss and American Malt Company, Supreme Court, New York County, February, 1904.) After the acquisition of the Neidlinger houses, the largest units in the consolidation, and four smaller malt houses, the total capacity was slightly less than 14,000,000 bushels. (During 1899, the Company sold 13,991,535 bushels.) At the meeting of July 11, 1900, the Directors voted not to operate some of the first acquired malt houses. They stated "total capacity 12,500,000 bushels." This was after the Neidlinger and six other malt houses had been bought.

A statement issued by the American Malting Company, April, 1900, states the nominal capacity of the houses originally purchased by the company to be approximately 16,000,000 bushels annually. Houses having a nominal capacity of over 1,000,000 were never operated. Others were closed soon after they had been acquired. Others were operated only at times of marked demand. In no sense can the nominal capacity of 16,000,000 bushels be looked upon as the actual capacity under even abnormal conditions.

[1] This estimate is further reinforced by the fact that the management paid in 1899, $1,500,000 cash for the Neidlinger properties, having estimated capacity of 2,800,000 bushels. 68 *Chron.* 185.

[2] Circular, November 8, 1899.

[3] There were mortgages on the separate plants aggregating $395,000 which the Company assumed. The estimate of $5,000,000 for the malt houses represents a little over half what the maltsters received in cash or preferred and common stock taken on a cash basis. The maltsters, judging from individual figures that have been shown the present writer, recognized that they were receiving about twice what their plants were actually worth. Some vendors, particularly Chas. M. Warner, received considerations out of all proportion to the value of the property they conveyed to the American Malting Company.

issued against it \$26,000,000 in stock. Soon after the securities of the American Malting Company were placed upon the market, the preferred stock was quoted at \$87 and the common stock at \$37. The syndicate subscribers, who acquired the preferred stock with a bonus of 50% in common, were therefore able to liquidate their holdings at a slight profit. On the basis of these early quotations, the assets of the Company had a market value of \$16,000,000, somewhat over twice a fair estimate of the tangible property. The maximum market value of the securities passing to the promoters amounted to approximately \$3,000,000, but owing to a subsequent rapid decline in market value, the majority of the promoters realized little pecuniary profit, and their business reputations were affected unfavorably by the circumstances surrounding the subsequent failure of the Company.

The entire promotion came under the review of the courts later, when several stockholders demanded of Moore and Schley that they account to the Company for any promoters' profits they might have received. The Appellate Division of the New York Supreme Court, in a decision of three to two, saw nothing fraudulent in the promotion. The American Malting Company, through its agreement with Eicks, received exactly what it bargained for, namely, the malting plants and the working capital. In the subscription agreement between Moore and Schley and the public, the Malting Company had no interest, and hence it could not demand an accounting for any secret profits which the promoters might have made in the sale of the stock to the public. The attitude of the court in the matter has more than passing interest, because it has tended to give a legal status to the secret profits made in a successful promotion.[1] Unfortunately, in this particular case, there was a distinct difference of opinion as to whether the promoters occupied a fiduciary position toward the planned, but as yet unincorporated, Company or toward the subscribers to this syndicate. The case did not reach the Court of Appeals unfortunately. As far as one can

[1] Supreme Court, Appellate Division, First Department, November, 1903. 92 *Appellate Div., N. Y.* 382. 87 *N. Y. Supp.* 369. Discussions of promoters' liability; see Machen, *Modern Law of Corporations*, Vol. 1, §§ 375–399.

judge, the law is by no means clear as to what acts of a promoter are those of agent or trustee for a Corporation as yet unformed legally, but the full nature of which is understood by all parties. The rights of a Corporation as principal, or *cestui que* trust, to require an accounting for all secret profits made by its promoters, occupying a fiduciary position toward it, seems to be a long recognized principle of law.

The Company commenced business on October 4, 1897. Alexander M. Curtiss, of Buffalo, was chosen President, the attorneys' clerk, Mr. Durand, having resigned. The chief selling maltsters were elected directors, and later appointed "Managing Directors" at annual salaries ranging from $4,000 to $10,000. E. R. Chapman, of Moore and Schley, was chosen Treasurer, at a salary of $8,000; and the moving genius of the whole promotion, Mr. Seymour Scott, became General Superintendent, at a salary of $10,000.[1] The banking interests assumed the actual management and appointed their own officers.[2] Almost immediately, the Company made the purchase of five small, antiquated, and inefficient malt houses at fictitious figures.[3] Three of these were acquired from Charles M. Warner and one from Seymour Scott. The aggregate cost of these amounted to $170,000, in money and $40,000 in preferred stock. The Company also acquired some thirty-eight grain elevators,[4] chiefly in Minnesota, for about $260,000.[5]

The most considerable acquisition, however, was the malting business of Neidlinger and Sons, New York. This was the largest single malting concern in the United States prior to the formation of the American Malting Company, and was at first its most formidable competitor.[6] The firm owned seven malt houses, the

[1] Authorized meeting of Board of Directors, held March 15, 1898.

[2] For example, the auditor from a distilling Company. Relatives of important officials were given "jobs."

[3] For example, one bought of Chas. M. Warner at Clyde, N. Y., for over $30,000 (Uhlmann Committee Report, March 5, 1900, Schedule B) was sold three years later for $5,250. (Galloway Committee Report, October 31, 1902.)

[4] The majority obtained from a certain H. J. O'Neil Grain Company.

[5] $263,252.76; Uhlmann Committee Report, p. 3.

[6] The business had been organized in 1863 as Schedel and Neidlinger, taken over by the co-partnership of Neidlinger, Schmidt and Company in 1866, and by

largest, at 63d Street and East River, occupied an entire lot and possessed valuable water frontage. The actual capacity of the plants was approximately 2,000,000 bushels, the sales during the year 1898–99 being in excess of this. When the first plan of a malting consolidation was discussed, Neidlinger and Sons were offered $2,000,000 in money for their business. The offer was refused and the idea of a consolidation was temporarily set aside. In the final promotion of the American Malting Company Adam Neidlinger was bitterly opposed to the idea of a combination, and refused all offers. Finally, in 1898, a year after the American Malting Company was formed, the Neidlingers entered into negotiations with a number of competitors looking toward the formation of a consolidation in direct opposition to the Company. At this point, two directors of the American Malting Company began to negotiate for the purchase of the Neidlinger business. The price of $1,500,000 was finally agreed upon by both parties.[1] Of this amount $100,000 was paid immediately out of the Malting Company's working capital together with 4,000 shares of the preferred stock, taken by Adam Neidlinger at a price of $85 a share, and the rest of the $1,500,000, $1,060,000 in amount, was obtained from a syndicate, the members of which bought the treasury preferred stock of the Company at

Neidlinger and Sons in 1892. At the time in question, during negotiations with the American Malting Company, the entire assets were owned by the founder of the business, Adam Neidlinger; the other two partners, George F. Neidlinger and Oscar von Bernuth, were partners only to the extent of participating in the profits of the business.

[1] Neidlinger demanded first (January 15, 1899) $1,875,000 — $1,500,000 in money, and the rest in stocks. The offer was refused by the Directors of the American Malting Company, who in turn offered $1,500,000. The Neidlingers were to take 3,000 shares of the preferred stock at $85 a share (January 21, 1899), but the allotment was changed to 4,000 later (January 23d). The first agreement was as follows (signed January 25, 1899).

Cash	$100,000
Preferred stock, 4,000 at $85	340,000
Six months' note	500,000
Nine months' note	560,000
	$1,500,000

About the middle of February the Directors decided to pay cash, instead of the two notes, according to plan outlined in text.

$80 a share, and the common stock at $30 a share. These prices were each about $4 less than the prevailing market prices. Adam Neidlinger subscribed to this syndicate for 600 shares of the preferred stock, and 1,000 shares of the common stock. Six of the Directors of the American Malting Company also subscribed to the syndicate, as did several prominent New York brewers.[1] The market prices of the stocks were maintained at levels above the syndicate prices, so that the Directors were in a position to dispose of their subscriptions at a profit had they so desired. There is every evidence to suppose that the brewers subscribed because of confidence in the permanent success of the Company. From the very beginning it had been a part of the policy of the promoters of the American Malting Company to enlist the pecuniary interest of prominent brewers and it was regarded at the time, as a favor to be allowed to subscribe to the syndicate. The price paid for the Neidlinger houses was excessive considering their antiquated character, but perhaps less excessive than the prices paid the old maltsters at the time of the formation of the Company. The standing and "good-will" of Neidlinger and Sons was of great value, as is attested by the fact that their contracts for sales of malt, taken over by American Malting Company, had been executed for about five cents a bushel more than the Company had obtained.

By these various acquisitions the working capital of the American Malting Company was depleted by something over $500,000. It has at times been stated that the failure of the consolidation could be attributed to the absorption of working capital through these early purchases. This seems to the present writer to be a contributing cause of but slight consequence. That the Company suffered, at its very inception, from a lack of working capital is perfectly obvious; but when it is remembered

[1]

Directors	Preferred	Common	
C. M. Warner	1,900	2,000	$212,000
Chas. H. Stadler	1,500	1,000	150,000
Seymour Scott	....	1,000	30,000
R. Nunnemacher	200	200	22,000
D. D. Weschler	200	200	22,000
A. M. Curtiss	200	100	19,000
Brewers			
George Ehret	1,000	....	80,000
E. C. Schaefer	1,000	1,300	119,000
Otto Huber	1,000	....	80,000
Anton Schwarz	600	....	48,000

that the selling maltsters disposed of their barley, malt, and open accounts for over $2,200,000, for which the Company obligated itself to pay in cash and notes; while the promoters started the enterprise with only $2,080,000 in cash, the absorption of working capital is not difficult to explain. At the very beginning the Company had current liabilities in excess of current assets to the amount of over $212,000. An additional expenditure of $500,000 for new plants was certainly ill-advised,[1] but not the only disastrous feature in the financial policy.

At first the Malting Combination appeared to be a success. Regular quarterly dividends of 1¾% were declared on the preferred stock from the beginning. At the time of the declaration of the seventh consecutive dividend, in June, 1899, an article stated that " the entire dividend on the preferred stock had been earned in the first five months of the year." [2] Later, it was announced that, in the year ending December 31, 1898, the first full year of the Company's history, the net earnings were over $1,000,000, and the surplus, after paying the full dividend on the preferred stock, amounted to nearly $200,000. By March, 1899, the market price of the preferred stock had risen to $88 a share, and that of the common stock to $38 a share. During this time a " stock pool " was being operated. When it was liquidated considerable profit was realized by its subscribers, some of whom were the directors and promoters of the Company.

It developed later that this apparent prosperity of the American Malting Company was unsubstantial. This is understood from a somewhat detailed examination of the Company's methods of accounting. On acquiring the plants of the selling maltsters, the American Malting Company purchased 3,812,208 [3] bushels of

[1] That the Directors anticipated unfavorable comments on their policy of deflecting working capital to the purchase of plants is indicated by the inspired article that appeared in the *New York Sun* in October, 1899, and was quoted by the *Commercial and Financial Chronicle*. The Company was then a borrower of money in the open market. The borrowing was explained by the large purchases of malt houses and elevators and the " requirements in conducting increased business." 69 *Chron.* 908, October 28, 1899.

[2] 68 *Chron.* 1178, June 17, 1899, referring to *New York Sun*, June 13, 1899.

[3] The figures upon which this and the following estimates are based were brought to light by Mr. Clark, an accountant who testified to the court in the

malt, manufactured and in process, from the selling maltsters. For this they paid $1,634,878.31, or 42.9 cents per bushel, almost exactly two cents a bushel in excess of what they should have paid, as the malt manufactured by them immediately on starting cost only 40.8 cents exclusive of general expenses. The two cents a bushel, or $76,000, seems to have been a secret profit which the selling maltsters made at the expense of the Company. This 3,812,208 bushels represented the full amount of the Company's business for the first five months, or until March 1, 1898.[1] During these five months, the "general expenses" and ordinary overhead charges, less rebates and miscellaneous credits, amounted to $111,149.78, or 2.9 cents for every bushel of malt sold and delivered during that period. Adding this 2.9 cents to the 42.9 cents paid to the selling maltsters, it is apparent that every bushel sold during this period, while the Company was disposing of the malt acquired from the old maltsters, cost 45.8 cents. During this period $1,781,909.79 was received for the 3,867,751 bushels actually sold. This is 46.08 cents a bushel. The net profit, therefore, on the malt acquired from the selling maltsters, the sale of which constituted five months of the Company's business, amounted to only .27 cent per bushel, a little over $10,000.

These facts, every one of the Directors, except possibly Mr. Schley, should have known, as they themselves were the selling maltsters or intimately familiar with the Company's accounts; yet on December 27, 1897, less than three months after the Company had commenced business, the Directors declared the first dividend on the preferred stock, a dividend requiring a disbursement of $219,450. Unquestionably the Directors could not have been certain that the dividend had actually been earned, as subsequent admissions on their part show that the general books of the Company for this period were not balanced from the accounts of the branch offices until some months afterward. Even as late as the Directors' meeting of March 15, 1898, Presi-

suit over directors' liability for the declaration of unearned dividends. Hutchinson and others *v.* Curtiss and American Malting Company, Supreme Court, New York County, February, 1904. Special Term, Part V, before Clarke, J., 45 *Misc.* 484. Abbreviated hereafter as Hutchinson *v.* Curtiss.

[1] The amount of malt actually delivered during these five months was 3,867,751 bushels.

dent Curtiss reported that the books had not yet been fully balanced. Nevertheless, the Directors declared a second regular dividend on the preferred stock, amounting to another $219,450. The actual profits, up to the first of March, amounted to a little over $10,000, and yet over $200,000 in dividends had already been paid by that time and another $200,000 was about to be paid.

The general books of the American Malting Company were completely balanced, for the first time in the Company's history, as of December 31, 1898. This was fifteen months after the commencement of business. For this period, the Company reported a net income of $1,076,449.79, out of which it had paid four quarterly dividends amounting altogether to $877,800, and was soon to pay a fifth dividend. This amount of net income was excessive, yet the computation of earnings is a somewhat difficult matter, owing to peculiar features of the malting business.

The accounting of the Malting Company presented certain difficulties. The accounts were carefully examined by Mr. Clark, an independent auditor, but his estimates of earnings are unduly small, owing to an unwillingness to permit the Malting Company to consider as an asset certain "increases" in the volume of malt occurring during the process of manufacture. One bushel of cleaned barley, weighing 48 pounds, produces 1.12 to 1.15 bushels of malt, so that the Company actually had a greater volume of malt to sell than it had purchased of barley.[1] Clark, following the strict English practice, was unwilling to allow a value for this "increase," on the ground that it had cost the Company nothing. In this position, it may well be contended that he was in error, because the "increase" of malt was explained as a normal incident to the process of manufacture, and was, therefore, in no sense a speculative or fortuitous gain. As it would be considered proper for a ranchman to place an inventory value upon his calves, although they cost him nothing in the strict accountancy sense, so it seems perfectly proper to

[1] Although there is a gain of from 12 % to 15 % in the volume of malt over the volume of barley, due to the expansion of the grain during germination, there is an actual loss in net weight. This loss occurs through the removal of dirt, the waste of the steep-water, of the screenings, of the moisture in the grain and of the evolution of the carbon dioxide produced in the process of germination.

regard the excess in volume of malt over barley as a legitimate asset. This position is farther reinforced by the perfectly obvious fact that the malt " increase " is being constantly sold and must therefore find its way, somehow, into the books of record of the Company. The following table summarizes the computation of earnings according to the three methods, that of the Company, that of the independent auditor and that of the present writer: —

	Figures as reported by American Malting Company, as of December 31, 1898 from October 1, 1897	Figures as computed from data supplied by Mr. Clark's examination of books, according to Clark's theory	Figures as computed by present writer from accounts of Company after allowing for increase of malt
Total gross receipts including inventories, (all book values by Company)	$1,199,013 11	$1,199,013.11	$1,199,013.11
Anticipated profit on sale of 6,733-856 bushels of malt contracted for, but not yet delivered	388,063.36		
Total Gross Income	$1,587,076 47	$1,199 013.11	$1,199,013 11
General Expenses	510,626.68	649,887.65	649,887.65
Miscellaneous over-estimates, for " increase " of malt during manufacture, bad debts, etc.		244,010.23	47,000 00 (Approx.)
Net Income	$1,076,449 79	$305,115.23	$502,125.46
Dividends (7%)	877,800.00	877,800.00	877,800.00
Net surplus	$198,649.79	—$572,684.77 (deficit)	—$375,674.54 (deficit)

Admitting, then, that the outside accountant was wrong in not allowing the American Malting Company to consider the " increase" in malt, incident to its manufacture, as a legitimate asset, it may still be said that the Company incurred an impairment of its capital in the payment of its dividends. Instead of the surplus of $200,000, after all allowances had been made by the Company's auditors, the records of the business of the Company for the fifteen months should have showed a deficit of over $300,000.[1]

The statement published by the American Malting Company was inflated in three different ways. The general expenses were much under-estimated. For example, certain items were charged to " cost of malt," when they should have gone to

[1] This conclusion is further emphasized by the fact that a gentleman intimately familiar with the costs of the various branch houses estimated the net earning at the time to be about 3 % on the preferred stock. This estimate was brought to the attention of the President of the Company, who chose to ignore it.

" general expenses"; and these items served to inflate the inventory value of the malt on hand. Again, the " increases " arising during the process of manufacturing malt were over-estimated, and bad debts and similar items disregarded. Lastly, the Company had anticipated the profit on more than the next half year's business, and had credited this to profit and loss account, without deducting the general expenses for the time during which the malt would be manufactured and delivered. This remarkable anticipation of profits amounted alone to nearly $400,000. Nothing was allowed for depreciation.[1]

The inflation of the income, by anticipating profits on unfulfilled contracts, is too important a matter to pass over without comment.[2] After balancing the books, as of December 31, 1898, it appeared apparently, that the Company had not earned its dividends, even with the methods of book-keeping then in force. Accordingly, we find on December 31st a credit in the profit and loss account of $388,063.36. This was entered as profit on 6,733,-856 bushels of malt sold on contracts on file with Sales Department.[3] As has been said, this item of prospective profit took no

[1] The accounts were actually audited by Jones, Caesar & Company at a later date, on behalf of a Committee of the Directors. They refused to sign an " unqualified certificate," but stated that the books were " substantially correct."

[2] A similar method of accounting was employed by the accountants for the United States Shipbuilding Company's promoters, and to some extent by the auditors of the United States Realty and Construction Company. *Infra*, Chapters IX and XVIII.

[3] This remarkable credit was made up of three entries — a debit of $2,482.79 being anticipated loss on certain contracts, and credits of $33,343.41 and $357,202.74 being anticipated profits on other contracts. To illustrate these remarkable entries, I subjoin an exact copy of the last one — *Copy of Journal Entries*, December 31, 1898, p. 100.

Entry No. 3.	Malt Account	$357,202.74	
	To Profit & Loss		$357,202.74
	To credit Profit and Loss Account with profit on 5,422,021 bushels of malt sold on contracts on file with Sales Department (made between Aug. 31, 1898, and December 31, 1898) at an average net price of .53/75 c. per bushel out of stock costing for barley and to manufacture (with interest, Insurance, etc. averaged and added) an average net price of .47/162 c. per bushel, or at a profit of .06/588 c per bushel on 5,422,021 bushels or $357,202.74.		

note of general or overhead expenses, notwithstanding the fact that it would represent the Company's operations for over half a year.[1] The general expenses for the next six months, according to the Company's own accounts, did actually amount to over two-thirds the anticipated profit.[2] Moreover, as was clearly shown from an examination of the books, the Company's malt account was constantly oversold, so that part of the deliveries would be in malt made from barley yet unbought, and subject to the conditions of a fluctuating market. Again, the manufacturing cost was as yet an undetermined item, since it was subject to many variable contingencies such as wages, freights, shortages, and the ordinary accidents incident to any process of manufacture. And finally, the credits were based merely on contracts with the brewers, which might be repudiated. The peculiar features of this remarkable method of computing profits by "dead reckoning," without taking account of general expenses or unforeseen accidents, must, to put it mildly, introduce complexities into the accounts of the next half year. Had the item remained as a credit in the profit and loss account, it would have been impossible to have entered in that account any of the transactions covered by the business of the next six months. The full half year's business had been begun and ended, so far as profit and loss was concerned, in that single entry. No general expenses were incurred, and no unforeseen contingencies encountered. As the malt on the various contracts would be delivered and paid for, under normal conditions, the result of each transaction would find its way separately into the profit and loss account. In this way, the business of the first half year would have passed through the books twice. To avoid this duplication, the original anticipatory entries would have to be reversed, as indeed was done. On August 31, 1899, the entries of December 31, 1898 were reversed, item for item.[3]

[1] During the first six months of 1899 the Company delivered 6,708,667 bushels, less than the amount represented in these items.

[2] $279,846.33.

[3] The actual reversal of the entry transcribed in the previous footnotes reads as follows:

It seemed valuable to give in detail some of the methods of accounting tolerated by the early management of the Malting Company, in order to show how unreliable a mere book-keeping surplus may sometimes prove to be. On the strength of this book-keeping, however, four more quarterly dividends were declared and paid on the preferred stock during 1899. This represented a total disbursement of $1,855,350, since the organization of the Company; whereas the actual profits were less than $1,000,000.[1] In the meantime, the original maltsters themselves had sold a large part of their securities, but the promoter [2] then had, and continued to hold, the large interest obtained at the time of the promotion. Considerable amounts of the preferred stock had been absorbed by small investment interests, on the strength of the liberal dividends and favorable statements. The number of stockholders had increased to nearly fourteen hundred.

The last dividend on the preferred stock was paid on October 15, 1899. Hardly two weeks afterward, at the meeting of the Board of Directors held November 2d, the following resolution was passed; "That the Company's outstanding obligations were about two million eight hundred thousand dollars ($2,800,-

Entry No. 3.	Profit & Loss	$357,202.74	
	To Malt Account		$357,202.74
	To reverse entry No. 3 on Journal No. 1, folio 100, dated December 31, 1898, by reason of the profit shown on undelivered contract liability being now involved through deliveries in P. & L. balance shown by branches.		

[1] According to the independent accountant, to December 31, 1898, $305,115.23; to December 31, 1899, $367,968.95; total earnings, $673,084.18. The present writer, admitting the malt "increases," but not depreciation, computes the profit for this period to be in the neighborhood of $900,000.

[2] Indirect evidence, which, the present writer believes, indicates that Mr. Scott had the permanent welfare of the Company at heart. Like all successful promoters, he was a man of great optimism and emotional enthusiasm. He held his stock through its rise and subsequent decline. He was afterward instrumental in the promotion of a very successful combination from which he derived considerable profit. Later, becoming interested in the promotion of some beet sugar plants, he hypothecated his stock in the American Malting Company, and lost it through the failure of the other enterprise. He remained in the employ of the American Malting Company, and died poor.

000), notes amounting to several hundred thousand dollars were being pressed for payment, and unless provided for, would go to protest. That the officers of the Company were unable to negotiate further temporary Loans." The Company had started with a working capital of over $2,000,000. It now had a floating debt of nearly $3,000,000, and "the credit of the Company had fallen so low that new loans could not be obtained." [1] Rumors of this condition reached the financial world, and market quotations of the preferred stock declined to $24, and of the common to $6.50 a share. At this juncture, several large stockholders came forward and loaned the Company between $700,000 and $800,000. At the same time, the Directors proposed an issue of $4,000,000 6% first mortgage bonds. This issue was ratified by the stockholders, and soon issued to them at 95%. It had been underwritten by a syndicate, managed by J. P. Morgan and Company, for a commission of 5% or $200,000, for the whole issue. The sale of the bonds netted the Company $3,600,000. This change in the form of capitalization was quite as significant and far-reaching in its consequences as if the American Malting Company had been compelled to resort to more formal reorganization, involving a refunding of the two stock issues and the probable judicial sale of the assets of the Company. In outward appearance, the reorganization was of the simplest kind, — the mere funding of the floating debt by means of the issue of a prior lien security, secured by the fixed assets of the Company. It was possible to adjust the finances of the American Malting Company by this simple means, because the promoters had burdened the Company with no funded debt. Had the same predicament arisen when mortgage bonds existed or even bonds with a provision prohibiting the issue of a prior lien security, the Directors would have found it impossible to extricate the Company by this simple means, and would have had to resort to a drastic reorganization similar in character to that of the United States Cordage Company or the American Bicycle Company, — two corporations which, with heavy issues of bonds already existing, found themselves seriously embarrassed with floating debt.

[1] Uhlmann Committee Circular, March 5, 1900, p. 1.

At the time that they consented to the creation of a mortgage on their property, the stockholders made it a condition that five new men be elected to the Board of Directors, and that the financial management of the Company be changed. This was done, and at the meeting of the new Board, November 10, 1899, a committee, with Frederick Uhlmann,[1] Chairman, was appointed to investigate the true condition of the Company. On March 5th following, the members of the Committee issued a circular statement to the stockholders. In this statement attention was called to many of the financial mistakes made by the early Directors of the Company, especially the anticipation of profits from contracts covering undelivered malt. The men who wrote the circular admit that the "earnings have been far below 7% per annum." They hazard the opinion that "economies in general administration, manufacturing, and distribution have not resulted from bringing the various plants into one ownership." This seems to be the truth for Mr. Suffern had found that the malt houses had been earning $1,300,000 a year, before their consolidation. By no manipulation of the accounts could it be shown that the American Malting Company had approached this earning capacity, although the promoters had stated that the earnings, by reason of consolidation, would be increased at least $1,000,000 a year.

Four days after the Uhlmann Committee circular was issued three stockholders, Messrs. Hutchinson, McElheny, and Bennett, the latter two lawyers in New York City, demanded of the officers that they bring suit against the members of the old Board of Directors, under whose management the Company had paid out unearned dividends. The statutes of both New York [2] and New Jersey [3] make the Directors jointly and severally liable to the corporation for dividends declared and paid from capital. The demand on the part of these stockholders was

[1] Frederick Uhlmann had sold a small malt house to the American Malting Company, at the time of its promotion. Subsequent developments have indicated that his rise into the administrative control of the Company was not for its best interest.

[2] Stock Corporation Laws of 1892, Section 23, applicable to foreign corporations, Section 60.

[3] Laws of 1896, Chapter 185, Par. 30.

referred to the counsel for the Company, Messrs. Reed, Simpson, Thatcher, and Barnum, who, in an opinion dated May 1, 1900, reported to the Company that it would be inadvisable for suit to be brought against these Directors. About two weeks later, Hutchinson and McElheny brought suit in the New York courts, in behalf of themselves and other stockholders, against those of the members of the old Board of Directors whom they could reach by summons. Reed, Simpson, Thatcher, and Barnum appeared as attorneys of record for about two months and then continued to serve as general counsel for the American Malting Company; at the same time they appeared as attorneys for certain of the defendant Directors.[1] Somewhat later another

[1] The relations of the various attorneys for the defendants seem to be as follows: When the McElheny and Bennett suits were first brought, Reed, Simpson, Thatcher, and Barnum served notice of appearance for the defendants. Realizing soon, however, their anomalous position they had Evarts, Van Cott, and Erskine substituted as attorneys for the Company. This special counsel acting for the American Malting Company, of which Reed, Simpson, Thatcher, and Barnum were general counsel, served answers on July 21, 1900, October 2, 1900, and March 3, 1902, praying for "judgment dismissing the complaint with costs." In the New Jersey, Appleton, suit, mentioned presently, W. H. Corbin, Esq. appeared as special counsel for the Company, but the demurrer in this suit was signed by John J. Treacy, "Solicitor of the American Malting Company." Treacy had been a dummy director of the Malting Company and a clerk in the office of Reed, Simpson, Thatcher, and Barnum. In brief, Reed, Simpson, Thatcher, and Barnum appeared as attorneys of record for the defendant Directors and acted as general counsel for the Company through the entire period of litigation. In addition, they actually appeared as attorneys of record for the Company in these particular suits at first, and remained such for two months, though later other attorneys were substituted.

Subsequently the officials of the Company denied that they had impeded the various McElheny and Bennett suits instituted in behalf of the Company. On July 11, 1900, Charles A. Stadler, as President of the American Malting Company, signed a "consent and order of substitution" that Evarts, Van Cott, and Erskine be substituted for Reed, Simpson, Thatcher, and Barnum in the Hutchinson *v.* the Directors suits. On July 21, 1900 the new attorneys, acting for the American Malting Company, petitioned that the Hutchinson complaint against the various Directors "be dismissed with costs of this action." In the similar petition of March 3, 1902, "Charles A. Stadler, President," signs the petition that the complaint be dismissed. Stadler signed a demurrer in the New Jersey suit. The officers apparently tried to suppress the "promoters' secret profit suits," referred to in the previous section. (Answer of American Malting Company praying that "said complaint be dismissed with costs," December 8, 1902, was sworn to by a Mr. Bethune, Secretary of American Malting Company.)

stockholder, Aaron Appleton, brought a suit in the court of New Jersey, on essentially the same grounds. After prolonged litigation, the suits in both states were decided in favor of the plaintiff stockholders.[1] The New Jersey case reached the Court of Errors and Appeals, where Chief Justice Gummere wrote a noteworthy opinion,[2] in which he declared that stockholders could, without offering to return dividends, bring suit in behalf of the Company against Directors, where it was evident that the Directors themselves would not act. "That, for the full protection of the Company, the liability of the Directors for the impairment of capital must be absolute," both with reference to stockholders and creditors, for solvent as well as insolvent corporations.[3] On March 9, 1905, just five years after McElheny and Bennett had demanded of the management that they institute legal proceedings, the defendant Directors effected a settlement of the whole matter, whereby they paid $500,000 in cash — $340,000 to the treasury of the Company, and $160,000[4] to the plaintiffs for the expenses of the suit, — and surrendered to the Company for cancellation $1,000,000 in par value of common stock. The opinions rendered by the courts in connection with these suits have added greatly to the security of minority stockholders in all corporations by strengthening the legal responsibility of directors.

At this point it is well to consider the fundamental reasons that led to the failure of the American Malting Company, for in view of the expectations of its promoters the Company was as conspicuous a failure as if it had been forced into bankruptcy. The promoters, on the basis of estimates of reliable accountants and their own confidence in large-scale production,

[1] The New York case, see New York County Special Term, February, 1904. *New York Law Journal*, November 30, 1904, gives full decision. For brief, see 45 *New York Misc.* 484; 92 *New York Supp.* 70. For discussion of principles see Machen, *Modern Law of Corporations*, Vol. II, §§ 1343–1362.

[2] For full discussion of legal principles involved and citations for powers of stockholders against Directors, see Machen *Modern Law of Corporations*, Vol. II, §§ 1149–1151.

[3] 65 *New Jersey Eq.* 375; 54 *Atl. Rep.* 454.

[4] Decline in the value of stock held by one of the plaintiffs, $29,000; accountants, $13,000; printing and miscellaneous, $18,000; attorneys' fees, $100,000.

announced that the profits of the consolidation would be $2,300,000. During the first year they proved to be less than $230,000 or less than one-tenth the original estimate.[1]

Two conspicuous reasons may be deduced to explain this divergence between the expected and the real. Competition was stimulated rather than lessened through the formation of the American Malting Company, and the men in the management ceased to give the same care and loyalty to the affairs of the consolidation that they had given to their own separate malt houses. The malting business is such that competition cannot be suppressed. The small malt houses entering the consolidation were, in the majority of cases, established by foreign emigrants who were the fathers or grandfathers of the men who controlled them in 1897. The founders had been uniformly very prosperous on account of their familiarity with the business, attention to detail, their thrift, perseverance and their pride in success. Similar men and similar conditions then characterized the brewing trade, so that close ties of friendship and racial coherence existed between the old maltsters and the old brewers. Business between the two was established on the firmest basis, and competition between buyers and sellers was more superficial than real. To a large extent these conditions were inherited by the second and third generation of maltsters, many of whom had risen to some local prominence and were aspiring to local social or political positions. At all events, the younger men attended carefully to the details of the malt business they had inherited, and even though they may not have possessed the administrative ability of the earlier generation they succeeded in holding their own

[1] The Company began business October 1, 1897. Its first year would have ended October 1, 1898, but the general books were not balanced until as of December 31, 1898. The profit for the fifteen months, according to Clark's estimate, was $305,115 and according to that of the present writer, $509,125. Pro-rating the latter amount for the twelve months gives $401,700. But this is undoubtedly too large. During the first five months, while the Company was marketing the malt and barley acquired from the selling maltsters, the profits amounted to less than $11,000. The profits during the rest of the year were not over $30,000 a month. There is reason to believe, therefore, that the actual net profits of the Company during the first year of its business amounted to less than $225,000, — less than one-tenth the profits estimated by the promoters.

positions with the local brewing trade, and in conducting the malt houses with profit. After the establishment of the American Malting Company, the brewers found that they were no longer dealing with the same malt house that had furnished them with malt for years. On the contrary, their malt now came from the "Milwaukee branch" of the "Trust" and their business dealings were restricted to hired salesmen. They preferred the older more personal, albeit more inefficient, method of doing business and easily found grounds of complaint. "The 'trust' is using poorer barley," or "The 'trust' can't make as good malt as ———." Provoked by the new conditions, the brewers turned to the smaller proprietary malt houses, the owners of which, stimulated by the aggressive policy of the American Malting Company, made every effort to increase their sales among the dissatisfied brewers. To make matters worse for the Company, it was discovered that the original contract, by which the selling maltsters agreed not to go back into the business for a period of years, could not be enforced at law. As a result many of the old maltsters, having disposed of their stocks in the American Malting Company, built new and improved malt houses and solicitated the trade of their old customers.

The competition of the small malt houses, never hoping to obtain more than a local trade, might have been offset to a large measure had the management of the American Malting Company obtained the anticipated economies of large-scale production. In this they failed. The management was not even as economical and efficient as the management of the separate malt houses in the earlier period of free competition. Men worked harder as proprietors of separate businesses than they did as directors of the consolidated Company. They ceased to give the business interests of the large organization the requisite care in small details, so that wasteful methods of manufacture crept in, which, coupled with lax and ill-organized selling policies, more than offset any gross economies, such as the savings in salaries and cross freight rates. As directors, the old maltsters delegated responsible decisions to paid employees, many of whom were selected because of family connection with important

officials. The business was no longer theirs, but belonged to the stockholders, and the evil of stock manipulation began to make itself felt. Some of the officers were "apparently more interested in the stock exchange quotations of the stock of the Company, than in giving their attention to the Company's business."[1] In brief, concentration in ownership brought out new and aggressive competition, and great administrative responsibilities. With these new conditions, the officers of the American Malting Company had neither the business ability nor the moral force to cope.

Events in the history of the American Malting Company, after the settlement of the stockholders' suits, center about various plans for reorganization. The Uhlmann circular of March 5, 1900, describing the early mismanagement to the stockholders, appended to its general comments the highly significant remark "Your Company's greatest drawback is over-capitalization, as compared with present value and present earning capacity." In the year immediately following, the men in the direction of the Company tried three successive times to induce the stockholders to consent to a reduction in the capital stock. The first two plans were intricate and expensive. Both were defeated because they seemed to jeopardize the suits concerning directors' liability and promoters' secret profits, then pending. The third plan proved successful in 1905, and as a result, a holding corporation with a small capital was created which took over a large majority of the stocks of the old American Malting Company.

The unsuccessful efforts to effect a reorganization need detain us but a moment. Although much discussion over the advisability of reducing the capitalization of the Company occurred at each annual meeting, nothing was done until three years after

[1] Circular of September 20, 1903. As mentioned before a stock pool was formed late in 1898 in which the men close to the management were associated. It lasted about six months. The prices of the stocks were successfully raised and the members of the pool obtained large profits. A second pool of longer duration was formed in 1899. This was unsuccessful and the members sustained heavy losses, due to the fact that the true condition of the Malting Company was rumored abroad, and the pool was too small to successfully maintain the prices of the stocks.

the idea was first proposed. On March 5, 1903, the stockholders received a circular, inspired by the management and signed by a Committee, of which Frederick Uhlmann was Chairman. At the time in question, the American Malting Company had securities outstanding as follows: —

Underlying mortgages..........	$ 256,000	
First mortgage bonds	3,861,000	
Total bonds		$4,117,000
Preferred stock.............. ..		14,440,000
Common stock		14,500,000
Total capital liabilities		$33,057,000

Against these, the Company had its plants, carried at a book value of over $27,000,000, admittedly excessive; and nearly $5,500,000 of net working capital. The Company's finances had improved considerably since the new management had obtained control in 1900; but, as the preferred dividends were cumulative, there remained charges in arrears of something over $3,000,000. The plan of reorganization suggested by the Uhlmann Committee involved the formation of a new Company with an authorized capital of $20,000,000, half preferred and half common; the bonds were to remain undisturbed. The peculiarly individual feature of the proposed reorganization was the deflection of net earnings from dividends to the rapid redemption of the first mortgage bonds. The net profits of the Company were to be paid to the trustee of the mortgage, who would, as rapidly as possible, purchase the bonds at the market price, but at not over 105%. Men close to the management then held most of these bonds, acquired originally at 90%. The preferred stockholders of the old Company were to receive 35% of new preferred stock in exchange for their old stock. Of this, 10% was to represent adjustment of unpaid dividends. As rapidly as net earnings were used up in the redemption of the bonds, preferred stock for an equal amount was to be issued to the new preferred shareholders. In other words, about half only of the new preferred stock would be issued in the first instance; and, from time to time, the Directors were to issue a stock dividend corresponding to the net earnings invested in the bonds of the

Company, and in this way the bonds were to be retired rapidly. The dividend on the preferred stock was to be quite as variable as the amount of preferred stock to be issued. During the time when the outstanding bonds amounted to over $3,000,000, the dividend was to be cumulative at the rate of 4%; after that, and until the bonds had been reduced to $2,000,000, at the rate of 5%; after that, at the rate of 6%, until, when all the bonds had been retired, the preferred stock should carry permanently 7% cumulative dividends. The common stockholders were to receive 25% of their holdings in new common stock. As the bonds were extinguished, new common stock was to be issued to them, as in the case of the preferred stock. The new common stock would carry no dividends until after all the bonds had been retired. When 7% had been paid, both on the preferred and common stock, the two classes of stock were to share equally in any further disbursements. This proposed reorganization can be understood from the table given on the next page. Over $1,000,000 of the preferred stock, and over $2,500,000 of common stock, were to go for the expenses of the reorganization, including the compensation of the Committee.[1]

The plan is worthy of careful study[2] because of several unusual features. Its chief advantage lay in the gradual extinction of the bonds, which increased the equity represented by the stocks, and tended to diminish the chances of a forced reorganization

[1] Plan and Agreement, March 5, 1903, p. 10.

[2] The various items in the plan of reorganization, so far as they relate to the future, can be seen at a glance from the following table:

	Old Company	New Company: Issued in first instance	New Company: To remain in treasury and to be gradually issued through stock dividends as the bonds are extinguished
Underlying mortgages	$256,000	$256,000	
First Mortgage Bonds	3,861,000	3,861,000	
Preferred Stock:			
(a) Issued	14,440,000 (35%)	5,054,000	
(b) To remain in treasury and be issued as bonds are retired	.....	....	$3,861,000
(c) Reorganization expenses	.....	1,085,000	
Common Stock:			
(a) Issued	14,500,000 (25%)	3,625,000	
(b) To remain in treasury and be issued as bonds are retired	.....	.....	3,861,000
(c) Reorganization expenses	. .	2,514,000	
Totals	$33,057,000	$16,395,000	

	OLD COMPANY					NEW COMPANY						
	Bonds	Fixed Charges	Preferred Stock	Contingent Charges	Common Stock	Bonds	Fixed Charges	Preferred Stock		Con-tingent Charges	Common Stock	
Underlying Bonds	$256,000	$15,000	....	....	....	$256,000	$15,000					
First Mortgage Bonds	3,861,000	231,660	....	....	....	3,861,000	231,660					
Preferred Stock	.. .	....	$14,440,000	$1,010,800	....	....		(35%)	$5,054,000	$202,160		
Common Stock	....	....	....	....	$14,500,000	....	....		. . .		(25%)	$3,625,000
Reorganization Purposes ...	..	....	....	....	....	. ..	...		1,085,000	43,400		2,514,000
Totals	$4,117,000	$246,660	$14,440,000	$1,010,800	$14,500,000	$4,117,000	$246,660		$6,139,000	$245,560		$6,139,000

SUMMARY	Old	New	Change Amount	Change Percentage New to Old
Securities bearing Interest	$4,117,000	$4,117,000	...	100%
Securities bearing Fixed and Contingent Charges ..	18,557,000	10,256,000	−$8,301,000	55%
Total Securities	33,057,000	16,395,000	−16,662,000	50%
Fixed Charges	246,660	246,660	....	100%
Fixed and Contingent Charges	1,257,460	492,220	− 765,240	39%

by foreclosure of the mortgage. The total capital liabilities were, moreover, cut in two. But it seemed unnecessarily intricate and expensive. After the whole plan had been executed, and the bonds extinguished, the entire capitalization would have been reduced from $33,057,000 to $20,256,000; it would have cost over $3,500,000 in stock to accomplish this, — nearly a third of the reduction in capitalization. In fact, the amount set aside for "expenses" — $3,599,000 of stock — represented over a fifth of the initial capitalization of the new Company. It was almost equal to the stock allotted to the common shareholders in the first instance.

As soon as the plan was announced, opposition arose from Messrs. McElheny and Bennett, the plaintiffs in the suits then pending on behalf of the Company to recover promoters' secret profits and dividends declared out of capital. It was alleged that the formation of the new Company would jeopardize the suits, since they would pass, as assets, from the old Company to the new, and the latter might or might not press them.[1] Circular after circular was issued by the various parties in their efforts to win over stockholders. In the course of the war of pamphlets, it became more and more clear that this plan would not become operative; and on June 15, 1903, the Committee of the management, of which Uhlmann was still Chairman, issued an "amended plan." This differed in three important respects from the first one proposed. A clause was inserted which was intended to protect the suits mentioned above;[2] the committee agreed to serve without compensation;[3] and the Directors were not required, but rather permitted, to purchase bonds for retirement.[4] Even this amended plan failed to meet the approval of the plaintiffs in the various suits;[5] and after considerable discussion, the whole purpose of reorganization was allowed to die down for a while.

[1] Circular of Hutchinson and McElheny, of March 16, 1903.

[2] Amended plan and agreement, dated June 15 1903, pp. 6 and 7.

[3] *Ibid.*, 2.

[4] *Ibid.*, 3.

[5] Circular of Joseph Leiter, McElheny and others, July 1, 1903.

In the meantime, the opposition party, McElheny, Bennett, and others, took the offensive. They proposed to replace men in the management by men of their own selection. Accordingly, a Committee, of which Marshall S. Driggs was Chairman, solicited proxies in behalf of a new Board of Directors, with which George F. Neidlinger was to serve as President.[1] In the subsequent contest, considerable bitterness and misrepresentation was indulged in on both sides.[2] At the annual meeting of November 12, 1903, the old management was successful; voting 155,000 shares, against 105,000 voted by the opposition.[3]

Nothing further was done toward the reduction of the stock of the American Malting Company until after the settlement of the various suits in March, 1905. During the latter part of the following month, J. G. Jenkins, President of the First National Bank of Brooklyn, issued a circular letter to each stockholder, inquiring whether or not he favored a reduction of the capital stock of the Company. The replies brought out very little opposition to a plan of voluntary reduction of capitalization, and early in July, a Committee, with Mr. Jenkins as chairman, sent to stockholders the description of an entirely new plan of reorganization. The Committee proposed to reduce the capitalization through the formation of a new Company, afterward called the American Malt Corporation. This was to have a capitalization of only $15,000,000, half that of the old Company. Of this amount, $9,000,000 in par value was to be preferred stock

[1] Driggs Circular of September 20, 1903.

[2] In explaining Mr. Neidlinger's withdrawal from the Board of Directors, "His resignation was requested by the Executive Committee for good and sufficient reasons." Circular of October 15, 1903, signed by all the Directors. An incident involving considerable personal feeling had arisen between the Chairman of the Board, Frederick Uhlmann, and George F. Neidlinger. The latter wanted to investigate a particularly favorable contract which the Hinckel Brewing Company had secured from the Malting Company. Uhlmann was said to be personally interested in the brewing Company. Neidlinger made himself objectionable as a Director by inquiring into and questioning the honesty of the Uhlmann management.

[3] 77 *Chron.* 1876. From apparently reliable evidence it appears that powerful banking interests took the side of old management and obtained the votes of the malting stocks held by New York brokers on margin account.

and $6,000,000 common stock. The preferred stockholders of the old American Malting Company were to receive 62% of their holding in new preferred stock; and the common shareholders were to receive 44% of their holdings in new common stock. The bonds were to remain undisturbed. The new preferred stock was to carry 4% cumulative dividends for the first two years, and 6% thereafter. The reorganization can be seen from a table given on the next page.

The plan could be recommended, both for its simplicity and for its conservatism. The amount of the stock was divided in two. The cumulative claims to dividends, after interest charges, were only a third as great, for the first two years, and a half as great thereafter. In brief, the reductions in both capital and charges were vigorous and thorough. They were, however, no more drastic than conditions required. The actual earning of the property during the three preceding years had averaged only $302,000, after interest payment and inadequate depreciation allowances. The new Company was obligating itself to pay over $350,000 during the first two years, and over $500,000 thereafter.[1] All things considered the plan of reorganization was more drastic than that proposed by the Uhlmann Committee two years before.

This plan was so favorably received[2] that, by October 21, 1905 it was declared operative;[3] and on November 30th the

[1] That this reduction of capitalization, even, was not sufficiently drastic has been shown by subsequent developments. The first dividend on the preferred was not paid until November, 1908. In no year has the full six per cent been paid, so that the preferred stock has large accumulated unpaid dividends. In 1907, the preferred stock declined as low as $17 and the common stock $2.50 a share, proportionately the lowest points in the Company's history. On the basis of these quotations the two stocks of the Company had a market value of approximately $1,678,000. There were then outstanding, $3,714,000 in mortgage bonds, which represented the addition of new capital. Ten years before the American Malting Company had started in business with approximately $7,000,000 of tangible assets and its securities had a market value of $16,000,000, approximately ten times as much as in 1907. In the meantime the only returns to the stockholders were the unearned dividends of the first two years.

[2] Some opposition arose, and postals were sent to stockholders as of October 30, 1905, alleging that the reorganization was inexpedient. The opposition amounted to little.

[3] 81 *Chron.* 1243.

AMERICAN MALTING COMPANY (OLD COMPANY) — AMERICAN MALT CORPORATION (NEW COMPANY)

	Old: Bonds	Old: Fixed Charges	Old: Preferred Stock	Old: Contingent Charges	Old: Common Stock	New: Bonds	New: Fixed Charges	New: Preferred Stock		New: Contingent Charges	New: Common Stock	
Underlying Bonds	$256,000	$15,000	....	....	. .	$256,000	$15,000					
Bonds	3,810,000	228,600	....	....	. .	3,810,000	228,600					
Preferred Stock	.. .	....	$14,440,000	$1,010,800	....	....		(62%)	$8,952,800	$537,168[1]		
Common Stock	....	. .	....	. ..	$14,500,000	....	....		.. .		(44%)	$5,896,000
Totals	$4,066,000	$243,600	$14,440,000	$1,010,800	$14,500,000	$4,066,000	$243,600		$8,952,800	$537,168		$5,896,000

SUMMARY	Old	New	Change: Amount	Change: Percentage New to Old
Securities bearing Interest	$4,066,000	$4,066,000	.	100%
Securities bearing Fixed and Contingent Charges	18,506,000	13,018,800	−$5,487,200	70%
Total Securities	33,006,000	18,914,800	−14,091,200	57%
Fixed Charges	243,600	243,600	. ..	100%
Fixed and Contingent Charges	1,254,400	780,768[1]	− 473,632	63%

[1] Contingent charges were $179,056 less than this amount during the first two years of the new Company's existence.

Reorganization Committee filed a certificate of incorporation for the American Malt Corporation with the Secretary of State in Connecticut.[1] The following April the Connecticut certificate was cancelled, and the Company was incorporated under the laws of New Jersey.[2] In September, 1906, the certificates for the new stock were ready for delivery, about 90% of the old securities of American Malting Company having been exchanged for those of the new holding corporation.[3] On January 9, 1907, the new stock was admitted to the New York Stock Exchange,[4] and the reorganization could be considered accomplished.

The somewhat unfortunate history of the American Malting Company turns chiefly upon the fact that the enterprise had less earning capacity than its promoters had expected. Singly and in a more or less localized competition with each other, the separate malt houses were conducted by their proprietors on a profitable basis. But when these malt houses were brought together the wastes and inefficiency of a diffuse management, with inferior business ability at the head, reduced the collective profits to less than a third what they had been when the malt houses were operated on a separate and competitive basis. The financial plan, however, had been formulated on the assumption that the profits would be increased through consolidation. The divergence between the anticipated and the real earnings was clear from the very beginning, but for a time the early management sought to maintain the position of the Company by declaring dividends when every principle of sound finance should have prompted the conservation of the Company's assets. As a result, the credit of the Company fell to a low point and a drastic readjustment of capitalization was avoided only through the issue of a considerable amount of first mortgage bonds. Finally, when the true character of the Company's earning power became clearly apparent, the stockholders voluntarily submitted to a cutting down of both the par value of the outstanding capitalization and the cumulative charges on the preferred stock.

[1] 81 *Chron.* 1611. [2] 82 *Chron.* 807.

[3] Circular Letter of stockholders' Committee, dated September 1, 1906.

[4] Application dated December 29, 1906, A-3312.

CHAPTER XII

The New England Cotton Yarn Company

Character of the yarn business, 306; early association of yarn manufacturers, 306; financial difficulties of the New Bedford yarn mills, 307; promotion of New England Cotton Yarn Company, 309; value of the property acquired by the Company, 314; apparent success of the New England Cotton Yarn Company, 317; underlying causes of failure, 318; failure, 323; reorganization, 325; policy following reorganization, 328; the Union Mills, 329; cancellation of lease and reorganization of the Union Mills, 331.

Chronological Summary

1896. Agreements among yarn manufacturers.
1897. Failure of certain New Bedford yarn mills.
1899. Promotion of the New England Cotton Yarn Company.
1902. Company's statement shows bad conditions of the Company.
1903. Reorganization New England Cotton Yarn Company.
1909. Lease by the Union Mills.
1913. Cancellation of lease and Reorganization of the Union Mills.

There have been two combinations in the cotton textile industry that parallel the large industrial combinations promoted in other industries in the years from 1897 to 1902. One was a combination of northern yarn mills, and the other a combination of southern duck mills. The resemblance in the history of the two attempts to introduce the economies of large-scale production in the textile industry are too striking to pass without comment. The combination of yarn mills was promoted under auspicious conditions with the support of local banks and strong investment interests. It failed. The reasons that underlie this failure are highly significant as showing the importance of skill of management in any textile business, and the extreme difficulty any combination meets in finding the requisite ability to manage successfully a large number of mills united under one organization. The history of the cotton duck consolidation is reserved for the following two chapters.

Cotton yarn is a semi-manufactured product used in a variety of other industries. It is taken largely by the knitting mills, to be used in the manufacture of underclothing, stockings, sweaters, and similar articles. Quantities of warp yarns are purchased by the weaving mills. Cotton yarns are used also as adulterants in silk and woolen goods, and to a considerable extent for the insulation of electric wires. The demand is very elastic; and under even normal conditions, our yarn mills tend to produce an over-supply. The conditions underlying the production of yarn resemble those controlling the production of any other staple commodity sold to another manufacturer, rather than to the ultimate consumer. The similarity between the production of yarn and that of malt is close. In both cases, the manufacturer purchases a commodity in a highly competitive market, subject to abrupt fluctuations, — for the prices of both barley and cotton vary directly with the world's annual yield of these products; the maltster and the spinner manufacture their goods without the assistance of patents or other monopolistic advantages; and both sell to other manufacturers in markets governed entirely by supply and demand. Both thus illustrate straight manufacturing businesses, where competition is met with at every point, where the gross profit of manufacture is represented very largely by a small margin between the cost of the raw material and the selling price of the product. The net profit is a mere differential; it may be changed easily to a loss through relatively small fluctuations in either market. Under these conditions, even a small profit can be assured only through superior managing ability and a wise financial policy. The American Malting Company and the New England Cotton Yarn Company each lacked these two requisites.

The New England textile business has always been subject to abrupt fluctuations which parallel but do not necessarily coincide with the fluctuations of general business. During the period in which the yarn business was growing in New Bedford and the surrounding towns, no effort was made to establish a trade agreement or other form of price-regulating association. But following the general trade depression of 1894, when the

yarn mills were suffering from over-production, drastic price-cutting became so prevalent that a number of the mills were selling yarn for less than the gross cost. To prevent the sale of yarn at unremunerative prices, an Association was formed which comprised a large proportion of the yarn mills of the country.[1] This Association did not have great success in achieving the purpose the managers had in view, although its members tried to enforce a " gentlemen's agreement " regarding prices,[2] but it served the purpose of bringing the manufacturers closer together and paved the way for the formation of the New England Cotton Yarn Company.

Other circumstances, however, should be regarded as the more immediate causes of the formation of the Company. The years from 1893 to 1898 were very unprofitable in the textile business, particularly in the yarn branch of the industry. During the first year or two, the mills were, in general, able to maintain their dividends by using accumulated surplus. Gradually, as the depression lengthened, dividends in all the textile cities dropped off in response to lessened earnings,[3] but certain yarn mills in New Bedford, notably the Bennett, Columbia, Howland, Rotch, and New Bedford Spinning, maintained their dividends, partly at the wish of the local banks, which were particularly interested in the continued high prices of their stocks. The banks consented to loan money beyond the net quick assets,

[1] The Association included the Columbia, Bennett, Howland, Rotch, New Bedford Spinning, Wamsutta in New Bedford; Globe, Sanford in Fall River; Cohannet and Nemasket in Taunton; Jenks Spinning Company of Pawtucket; Shenandoah in Utica, N. Y.; and three or four mills near Philadelphia.

[2] According to very reliable reports the members of the Association would meet informally and agree to raise prices after a certain date. " One man in particular was very crafty. When the meeting was held — say on the first of May — to fix price and a rise of one cent per pound was agreed upon, this manufacturer would slip out of the meeting and call up many of the best customers of the trade and tell confidentially that after a certain date the price was to go up so much a pound, but that they might come in on the old price, if they gave an order that night." (Very reliable statement by man familiar with the Association. The manufacturer referred to operated one of the mills absorbed by the New England Cotton Yarn Company. He opposed selling to the combination.)

[3] In 1896 the average dividend rate on Fall River mill stocks was 5.95 %, in 1897 it was 3.38 % and in 1898 only 2.22 %, less than a half what it had been at the time of the general business depression following the panic of 1893.

and dividends were maintained on the basis of borrowed money.[1] Finally in April, 1897, a note of the Bennett mill went to protest in a Boston bank, and the burden of accumulated debt was laid bare.[2] The resulting difficulties of the New Bedford mills became known generally and the banks outside of Bristol County began to discriminate against all yarn mill paper. In order to keep the mills in operation, it was imperative that their quick assets should be well above their quick liabilities, as textile companies are always large borrowers on short term notes to finance their purchases of raw material. To accomplish this end, the banks, which held much of the current indebtedness, and the officers of which owned or controlled considerably more than a majority of the stocks of the distressed mills, were forced to put through a series of reorganizations in which they furnished new capital and became the real owners of the mill property.[3]

[1] The treasurer of the Columbia and Bennett mills, one Hadley by name, seems to have been responsible for the irregularities. (See *New Bedford Mercury*. April 14, 1897 and fol. Abbreviated summary in *Fall River Weekly News*, April 28, 1897. An interview in a Boston newspaper of the period, throws the responsibility directly upon the local banks. "It was this matter of dividends that caused all the trouble, in my opinion. The great majority of the stock, some 75 %, was held by the banks and they and their managers wanted the stock to make a good showing — even if the money was not earned, saying that if any was needed they would advance it, and thus make in two ways, by advancing at high rates of interest, and receiving it back again in dividends." *Boston Herald*, May 15, 1897.

Too much responsibility, however, should not be thrown on the local banks, as this quotation would indicate. From contemporary comment it is clear that Hadley made misstatements concerning the available net quick assets. "Mr. Hadley, who was treasurer of both corporations [Bennett and Columbia] confessed that he had made false returns to the state, to the banks and to the stockholders, and that instead of owing $1,400,000, as he had reported, they owed nearly $4,000,000." *Boston Herald*, April 17, 1897. Much of the difference had been deflected from net quick assets to plants, and the mills themselves had been kept in unexcelled condition.

[2] Report of accountant showed: —

Bennett Mills — excess of quick liabilities	$1,430,855.99
Columbia Mills — excess of quick liabilities	1,401,077.18

[3] The commonest method of reorganization of a textile mill, which finds itself temporarily embarrassed by the excess of debt, is for the stockholders to decrease the capital stock by a certain amount and reissue a new amount of stock for money. For instance, if a mill of $1,000,000 capital stock had need of new capital to the amount of $500,000 in order to increase its net quick assets, the stockholders would probably reduce the capital by 50 %, — each stockholder surrendering half of his

In furtherance of this purpose the creditor banks of the Bennett Manufacturing Company took 57% of their claim in stock of the reorganized company and 24% in cash; those of the Columbia Spinning Company, 42% in stock and 18% in cash.[1] The two mills were united in one corporation under the control of directors chosen from the banks.[2] The other New Bedford mills which were in difficulties underwent a series of drastic reorganizations involving a heavy assessment on the stockholders. As a result of these changes, the mills passed into the practical ownership of the banks.

Toward the end of 1898, the yarn mills began to experience the effects of returning prosperity, and the shares in the reorganized mills appreciated rapidly in market price on the strength of increased earnings. Under these conditions, the banks looked about for a means whereby they could dispose of their mill stocks, acquired during the reorganization period, without suffering a loss.[3] At first it was rumored that English capital had been enlisted in the formation of a consolidation of all the yarn mills of the country, on lines similar to the American Thread Company. As usual in such cases, the rumors exaggerated the importance of the combination.[4] Yet certain interests in the cotton yarn business[5] were actively engaged in securing

holdings — and then reissue $500,000 of new stock for money. Bonds or funded debt of any kind would be frowned upon as affecting unfavorably the credit of the company at the banks. (See also p. 340.) As this form of reorganization is purely voluntary on the part of the stockholder, it is resorted to only in an emergency and cannot ordinarily be consummated without difficulty and friction.

[1] *Fall River Weekly News*, July 28, 1897.

[2] Five directors; two representing New Bedford banks; one, Fall River banks; one, Providence, and one, Boston banks.

[3] The Savings Bank Commissions advised the disposal of the mill stocks, according to report. *Fall River News*, April 28, 1899.

[4] " A special from New Bedford . . . says one of the biggest combinations yet conceived is in process of formation today, . . . it is nothing less than the purchase by an English syndicate of the entire cotton yarn industry of the United States, a purchase which will require considerably over $100,000,000 capital. This big scheme grows out of the financial troubles of the New Bedford mills during the past few years. It seems that the New Bedford banks grew weary of carrying the load and sought a way of relief. They finally interested some wealthy English capitalists." *Fall River News*, April 5, 1899, page 3.

[5] In New Bedford, Andrew G. Pierce and W. W. Crapo; in Fall River, Wm. B. Hawes and E. B. Jennings; in Taunton, Peter H. Corr and Edw. B. Maltby.

options on the stocks of the various yarn mills. The task was easy in the case of the New Bedford mills, as the virtual control was held by the various banks,[1] the officers of which were the instigators of the combination. It was more difficult to acquire the two yarn mills in Fall River, as their stocks were more widely distributed.[2] This was true also, to a less extent, of the two Taunton mills, although certain stockholders were particularly desirous of disposing of their mills to the proposed consolidation. The local bankers and the members of the presumptive syndicate remained in the background, while their representatives[3] solicited options on the various stocks. It developed later that Kidder, Peabody & Company, of Boston, had been induced, either by their English correspondents or the local bankers, to stand back of the proposed combination. The bankers paid $8,390,000 for five mills in New Bedford, three in Fall River, and two in the adjoining city of Taunton. The net book value of the mills amounted to $6,740,593. The nominal strength of the consolidation was 583,400 spindles; the actual operating capacity was upwards of half a million spindles, of which about two-thirds were mule spindles. Under average conditions, these mills were capable of producing some fifty million pounds of yarn a year. The details of the separate mill capacities, the nominal prices of the stocks during the year previous, the prices paid for the stocks by Kidder, Peabody & Company, and the various summaries can best be seen from the

[1]

Mill	Number of banks interested	Total Number of Shares	Amount held by Banks	Per cent of Control held by Banks directly
Columbia-Bennett	91	18,000	12,060	67%
Howland	39	8,000	3,664	45.75%
Rotch	36	7,500	3,198	42.64%
New Bedford Spinning	19	2,500	1,711	68 44%

Columbia-Bennett report as of February 27, 1898; Howland as of December 6, 1898; Rotch as of November 1, 1898; New Bedford Spinning as of November 23, 1898. Figures computed from statistics printed in *New Bedford Mercury*. Reprinted in *Fall River News*, May 5, 1899 with comments which indicate local confidence in the figures.

[2] It should be stated, however, that the Globe mill, the largest of the Fall River group, was almost bankrupt and the banks all over the country were discriminating against its paper. E. B. Jennings, who had become Treasurer of the mill four months before, coöperated in bringing about the combination. The idea of the combination seems to have been first suggested by Peter H. Corr of Taunton.

[3] Barrow, Guthrie, and Wade.

tables given below and on the next page. Some of the prices paid were especially high, and were based upon the fact that the local bankers, who promoted the combination, counted upon the general feeling of confidence in combinations to enable them to sell their yarn mill stocks at sufficiently high prices to free them from their previous losses.[1] In one case,[2] the price paid represented an indirect profit to one of the promoters.

	Capitalization	(May, 1899) Book Value Lands and Machinery	Inventories	Cash and Receivables	Net Debt	Net Quick Assets	Total Net Assets Book Value
New Bedford	$	$	$	$	$	$	$
Columbia-Bennett	1,800,000	1,800,000	510,027	169,630	477,285	202,372	2,002,372
Howland	800,000	1,013,294	174,819	51,626	473,496	(*d*) 247,051	766,243
Rotch	750,000	903,291	197,795	57,304	298,344	(*d*.) 43,245	860,046
New Bedford	250,000	196,678	79,540	24,779	83,162	21,157	217,835
Fall River							
Globe	1,200,000	1,294,343	298,712	140,325	598,129	(*d*.) 150,092	1,144,251
Sanford	500,000	547,269	297,092	in invent.	214,500	82,592	629,861
North Dighton	30,000	52,004	17,591	10,070	47,168	(*d*.) 19,507	32,497
Taunton							
Cohannet	600,000	600,000	163,960	191,791	300,430	55,321	655,321
Nemasket	400,000	521,632	162,331	57,388	309,184	(*d*.) 89,465	432,167
Totals	6,330,000	6,928,511	1,901,867	711,913	2,801,698	(*d*.) 187,018	6,740,593

Book value of lands, machinery and net quick assets $6,740,593

[1] Either intentionally or unconsciously the bankers made it appear that the mills had been secured at bargain prices. Witness the following from Kidder, Peabody & Company's prospectus of July 5, 1899. "About two years ago, through the misconduct of the Treasurers of the New Bedford Mills, these properties were left in such financial condition that the creditors were obliged to take the properties and reorganize them on a basis of capitalization much below what it would cost to reproduce them.

"The ownership therefore of the Rotch, Howland, New Bedford Spinning Company, and the Bennett Mills fell largely into the hands of Banks, which, as a result, held in these mill stocks an asset which they were not allowed by law to purchase. It has been possible, owing to this fact, to secure a controlling interest in these mills at low prices compared to cost of reproduction.

"The Fall River and Taunton Mills were then willing to sell at moderate prices rather than risk competition with a company controlling several mills and thereby being able to introduce economies not possible in a single mill."

[2] The North Dighton mill, having $19,507 net debt with a book value of the fixed assets of only $52,000. The mill had been built over seventy-five years, and was altogether antiquated. It was soon dismantled.

Mill	Capitalization	Book Value Lands and Machinery	Net Quick Assets	Total Net Assets (Book Value)	Nominal Market Value during preceding Year	Nominal Market Value before Combination	Prices paid by Kidder, Peabody & Co.	Cost Price of the Constituent Corporations	Net Price paid for Mill Property[1]	Number of Spindles	Net Cost per Spindle for Mills
New Bedford:											
Columbia-Bennett	$1,800,000	$1,800,000	$202,372	2,002,372	$90	$1,620,000	$140	$2,520,000	$2,317,628	173,000	$13.40
Howland	800,000	1,013,294	247,051 (def.)	766,243	70	560,000	110	880,000	1,127,051	77,600	14.52
Rorch	750,000	903,291	43,245 (def.)	860,046	75	562,500	120	900,000	943,245	46,300	20.37
New Bedford	250,000	196,678	21,157	217,835	100	250,000	200	500,000	478,843	40,400	11.85
Fall River:											
Globe	1,200,000	1,294,343	150,092 (def.)	1,144,251	77½	930,000	110	1,320,000	1,470,092	97,400	15.09
Sanford	500,000	547,269	82,592	629,861	95	475,000	120	600,000	517,408	37,400	13.83
North Dighton	30,000	52,004	19,507 (def.)	32,497	50(?)[2]	15,000	100	30,000	49,507	5,600	8.84
Taunton:											
Cohannet	600,000	600,000	55,321	655,321	150[2]	900,000	200	1,200,000	1,144,679	73,200	15.63
Nemasket	400,000	521,632	89,465 (def.)	432,167	80[2]	320,000	110	440,000	529,465	32,500	16.29
Total	$6,330,000	$6,928,511	$187,918 (def.)	$6,740,593	....	$5,632,500	....	$8,390,000	$8,577,918	583,400	....

[1] Cost price of stock with net quick assets added or subtracted according as the net quick assets show deficit or surplus.

[2] The stock of the North Dighton, Cohannet, and Nemasket Mills had not sufficient market to give the stocks even nominal quotations. The prices here given are little more than rough estimates, but have been made with great care on basis of local estimates, assets, and spindle capacity.

A charter for the New England Cotton Yarn Company was obtained July 6, 1899. It had an authorized capitalization consisting of $6,500,000 5% first mortgage bonds, the same amount of 7% cumulative preferred stock, and $5,000,000 of common stock.[1] Of these amounts, $5,700,000 in bonds, and $5,000,000 each in preferred and common stocks were issued immediately. Preferred stock to the amount of $3,000,000 was taken by the stockholders of the old companies at $95 a share.[2] Practically all of the common stock was taken by the mill operators, the bankers who held the notes of the subsidiary mills, and the underwriters, at a nominal valuation of approximately $15 a share; it never secured a public market, and was recognized by the majority of people as representing merely an intangible equity of possible earning power. This common stock was, in effect, the only promoters' and bankers' profit realized. The bankers paid $8,578,000 for the mill stocks, and furnished $1,750,000 in new money, making a total known expenditure of $10,325,000. The actual expenses in forming a consolidation of this size must have amounted to $200,000. The bankers received from the sale of the bonds and preferred stock $10,550,000. Their profit, therefore, was part of the common stock, which, at a valuation of $15, represented a promoters' profit of $750,000. As this stock had no market, the profit was at most nominal; as the consolidation proved a failure, even this nominal profit was wiped away. In the end the outside bankers obtained no profit from the combination.

Early in July, 1899, the bonds and the preferred stock were offered for public subscription at par by Kidder, Peabody & Company and by their Baring correspondents in New York and

[1] Certain provisions of these capital liabilities deserve passing comment. The bonds were to run for thirty years. They were safeguarded by a sinking fund of 1% on the outstanding amount, payable before any dividend disbursements on the preferred stock. An additional sinking fund payment of 4% had to be made before providing for common stock dividends. The sinking fund could be used for redemption of bonds or renewal of property. The bonds could be retired at 110 and the preferred stock at 140.

[2] Price stated in agreement sent by Kidder, Peabody & Co. to the various stockholders. Reprinted in *Fall River News*, June 20, 1899. Amount taken stated in Kidder, Peabody & Co.'s public prospectus dated July 5, 1899.

London.[1] Such was the confidence in the enterprise, that in less than a week the public allotment of $2,000,000 preferred stock and all the bonds were greatly over-subscribed; and on all subscriptions in excess of $2,000 only 28% in bonds and 65% in preferred stock was allotted.[2] Presently both were admitted to the Boston Stock Exchange list, and the preferred stock soon sold at $105 a share.

The advertisement issued by the bankers, at the time the securities of the New England Cotton Yarn Company were offered for public subscription, contained the following statement:

Estimated cost of replacement of plant alone.........	$10,700,000[3]
Additional assets, including $1,750,000 new money, now provided, about	2,300,000[4]
	$13,000,000

It is extremely difficult to form a correct estimate of the value of the property acquired by the Cotton Yarn Company. Although several of the mills, particularly the Howland, Globe and Nemasket showed a deficit in their net quick assets, others, particularly the Rotch, Cohannet and New Bedford Spinning, possessed very valuable trade-marks, and manufacturers all

[1] Prospectus, July 5, 1899. Advertisement, 69 *Chron.* 1776, IX. [2] 69 *Chron.* 131.

[3] This estimate was based on a letter from F. P. Sheldon, "a mill engineer," Providence, R. I., written to Kidder, Peabody & Co., under date of June 29, 1899, saying, "I have carefully considered the question of the probable cost of reproduction, as running plants, of the nine mills to be included in the New England Cotton Yarn Company, and am of the opinion that it is fairly represented by the bonds and preferred stocks to be issued, amounting to $10,700,000.

"The estimate refers only to cost of real estate, buildings, and machinery, and takes no account of the cash assets, nor of the value of the good-will of the various existing Companies."

The bankers were in error in stating to the public the reproduction cost of the mills in any light that would lead to an inference that there was a relationship between cost of reproduction and present value.

[4] 69 *Chron.* 1776, IX. In the prospectus of July 5, 1899 it was stated, "This Company will start with quick assets of over $2,000,000—$1,750,000 in new money being added as quick capital." Actually the quick assets amounted to approximately $1,583,688 — the "new money" less the deficit in quick assets. The statement of the Company itself, as of July 15, 1899, indicated net quick assets of only $1,670,166, even though accrued taxes should be reckoned as a deferred and not a quick liability. (See page 333.)

over the country sought the yarns spun at these mills. Yet the estimates upon which Kidder, Peabody & Company sold the securities of the Company to the public presumed to take no account of this value of good-will.[1] Several indirect methods may be used in reaching some conclusion concerning the value of the mill property. Less than a year before the formation of the combination, the market value of the securities of the several mills aggregated $5,632,500.[2] The book value of the mills amounted to $6,740,593 net. The underwriters of the combination paid $8,390,000 for the mills, but every one at all conversant with the situation admitted that the prices realized by the stockholders were excessive.[3] Valuation on the basis of construction gives us a hint only of their value. As already stated, some of the mills were run down.[4] The machinery in seven of the ten separate mills was old; many of the mules were of heavy English construction, and could be operated only with high labor cost. The buildings were not of modern construction. It is, therefore, as has been said, exceedingly difficult to form any just estimate of their value as operating mills. The Tariff Board computed the replacement value of an average yarn mill at $10.828 [5] per spindle. This is undoubtedly too low. A new yarn mill of thoroughly improved construction, recently built in New Bedford, cost between $23 and $24 a spindle. But the mills of the New England Yarn Company were far from new, and construction costs were less in 1899 than ten or twelve years later. If, then, we estimate the value of the mills entering the combination as approximately $14.50 per spindle for the five hundred thousand spindles the Company could profitably operate, and $8 per spindle for the idle spindles we are at least liberal in our computation. This gives a value of $7,917,200. From this should be subtracted $187,918,

[1] See letter of F. P. Sheldon quoted in note 4, page 314. [2] Table, page 312.

[3] This is gathered from comment at the time in New Bedford and Fall River papers and from statements by the various individual manufacturers.

[4] The Sanford, built in 1892, by some of the stockholders of the Globe (a description of the Sanford in *Textile World*, December, 1892, page 27) and the Rotch, built the same year were the newest. The New Bedford spinning mill, built in 1883, was the first yarn mill in the city.

[5] II *Cotton Manufacturing*, 465.

the debt in excess of net quick assets. The various estimates of the value of the property are then: —

Market Value within one Year	Book Value of Mlils	Cost Price to N. E. Cotton Yarn Co.	Value on Basis of Spindle Valuation
$5,632,500	$6,740,593	$8,390,000	$7,730,000

It seems clear, therefore, that the mill property acquired by the New England Cotton Yarn Company had an actual value of not more than $7,500,000. The bankers added $1,750,000 net working capital making the total property owned by the Company approximately worth $9,250,000. Against this was issued $15,700,000 in securities, — that is, over $26 [1] net per spindle for the entire rated capacity of all the mills. On the basis of market quotations, the securities of the Company were valued at $11,700,000, if we consider the common stock worth $15 a share.

Accountants estimated the annual earnings of the constituent mills as $1,106,197.40,[2] approximately $2 a spindle. The fixed charges on the new bonds would require only $285,000 or approximately fifty cents a spindle, the contingent charges on the preferred stock, $350,000 more or approximately sixty cents a spindle, and the total fixed and contingent charges, $635,000 or approximately $1.10 per spindle. In the light of the earnings, the various mills were making during the early part of 1899, this optimistic estimate was undoubtedly conservative; but if the accountants had computed the earnings for 1897 and 1898, it was not so, — a fact which emphasizes the importance, in computing earnings, of taking into consideration years both of depression and of prosperity. In addition it was alleged that the new Company would be able to save $500,000 in the management of the mills by reducing competition and apportioning each mill to a particular range of yarns.[3] At the time the mills of the Company manufactured about 68% of the yarn sold to the trade.

[1] After subtracting from the issued capitalization the net quick assets.

[2] "The aggregate net earnings as reported by Deloitte, Dever, Griffiths and Company of the separate companies for the last fiscal year — $1,106,197.40." Prospectus of July 5, 1899, summary, 69 *Chron.* 1776, I.

[3] *Taunton Gazette*, June 20, 1899.

It is interesting to note that the only other important cotton textile consolidation, — the combination of cotton duck mills,[1] — was promoted at the same time. The two corporations began life on almost the same day, and the same uncritical confidence in economies was present in the minds of both groups of promoters. The textile industry had been susceptible to severe fluctuation, and it was believed that stability and increased earning power would necessarily result from combination.

To all outward appearances, however, the New England Cotton Yarn Company seemed successful at first. A dividend of $3\frac{1}{4}\%$ was paid January 1, 1900, for the five and a half months of the Company's existence, after provision was made for the fixed charges and the sinking fund on the bonds. The statement of June 30, 1900, showed a prosperous business. The full interest and preferred dividends had been earned apparently, and besides, upwards of $400,000 had been carried to improvement and profit and loss accounts.[2] Without charges to depreciation, the net earnings of the Company were in excess of $1,000,000, the very amount, in fact, that the accountants found to be the aggregate earnings of the constituent mills prior to consolidation. At the same time, the net quick assets, which stood at $1,646,212 the July before, had been increased to over $2,000,000. Notes payable had been reduced about $2,000,000, and now stood at only $650,000, while the cash had been reduced only about $1,500,000. On the whole, the financial position of the Company was strong and its prospects for success bright. The statement of June 29, 1901, showed signs of diminishing prosperity. The full preferred stock dividend was paid after providing for the fixed charges and the sinking fund. Yet the profit and loss account was increased by only about $34,000. The management had charged off to depreciation on plants carried at approximately $14,000,000 only the sinking funds on its bonds, about $60,000 in amount, while at the same time they had increased the plant account by charging to improvements over $300,000. The noticeable thing about the statement was the

[1] *Infra*, Chapter XIII.

[2] See abbreviated balance sheets, *infra*, p. 333.

increase it showed in inventoried materials, and in outstanding notes, the former from $2,200,000 to $3,800,000 and the latter from $650,000 to nearly $3,000,000. The Company was, it seemed, finding difficulty in disposing of its goods.

The statement of June 28, 1902 was not reassuring. The materials on hand still remained well above $3,000,000, notes and accounts payable were a little less, — about $2,800,000, — but the money had fallen to the lowest point in the Company's history. With less than the sinking fund of $60,000 charged to depreciation, the Company showed less than $5,000 credited to profit and loss account. The full dividend on the preferred stock had not been earned and the Directors had authorized the Company to borrow the last dividend payments from the bankers, taking renewed hope from a slightly lower level for spot cotton. These expectations of better trade conditions were premature, but before describing in detail the circumstances which preceded the reorganization of the New England Cotton Yarn Company, it is important to understand the underlying conditions that led to its failure.

From the first the actual administration of the mills of the Cotton Yarn Company was in the hands of practical men[1] but the detailed management was given by the bankers to a man of limited perspective. In New England textile circles it has been the custom to appoint one man to the entire management of the business, and to give him free hand in all particulars.

[1] This is seen from a list of the first directors:

Andrew G. Pierce, President, The Bennett and Wamsutta Mills, New Bedford.

Edward B. Maltby, Vice-President, Cohannet Mills.

Andrew G. Pierce, Jr., Vice-President, Treasurer of Pierce, Rotch, and Howland Mills, New Bedford.

J. Frank Knowles, Chairman of Board, Acushnet and Hathaway Mills.

E. S. Draper, Draper Company.

T. E. Brayton, Union Cotton Manufacturing Company.

E. B. Jennings, Globe Mills.

J. E. Stanton, Jr., Bennett Mills.

C. M. Weld, Banker.

C. L. Lovering, Nemasket Mills, Merrimac Mills, Massachusetts Cotton Mills.

A. H. Mason, Sanford Mills.

W. A. Gaston, National Shawmut Bank, Boston.

Robert Winsor, Kidder, Peabody and Company.

If he made a " success " of the mill, he was retained by the Directors, otherwise, another was tried. In this particular case, the man chosen by the bankers for the administration of the mills was not equal to the task. He had been successful in the conduct of single cloth mills, but his methods were not appropriate to the many-sided problems of a combination of 500,000 spindles. He antagonized large portions of the trade by policies which others considered narrow and, in the end, uneconomical; customers he should have retained turned to competitors. He failed to realize the difference between a fifty thousand spindle mill, and a five hundred thousand spindle combination, paying attention to matters of insignificance, while neglecting the larger issues of trade policy. The other practical mill men on the Board of Directors had their own businesses to attend to, and could give neither the time nor the thought to the affairs of the New England Cotton Yarn Company that their positions would seem to call for. Three other elements worked against the success of the New England Cotton Yarn Company, — the increase in labor costs which made it necessary to change the type of machinery, the increase in price of raw cotton, which restricted the demand for yarn, and an entire change in selling methods, which antagonized the commission houses and indirectly led to increased competition. As these elements of failure are somewhat individual, and yet analogous to corresponding elements in the history of other combinations, they are worthy of some detailed attention.

When the New England Cotton Yarn Company acquired the subsidiary mills, over two-thirds of the spindles were mules. Their operation required distinctly skilled labor.[1] Mules must be used in spinning the fine yarns, but for the coarser numbers ring spindles are more economical. The point where rings can be more economically substituted for mule spindles depends on the relative labor cost of operation, and on the market conditions affecting the two kinds of yarn. If the New England Cotton Yarn Company's trade had been almost entirely restricted to the finer

[1] Mule spinners receive wages somewhere in the vicinity of $15 a week, whereas ring spindle operatives receive $7.50 a week, — exactly half.

yarns,[1] the extensive equipment of mule spindles would have been economical in operation, for the higher value of the fine yarns fully offsets the additional wages paid to the mule spinner.[2] But, unfortunately, the competition of foreign yarns is keener in the fine numbers, and the demand is distinctly more restricted. So the New England Cotton Yarn Company found it necessary to increase its proportion of coarse yarns, a field where its competitors, with their ring spindles, could produce more cheaply. Subsequently the management threw out thousands of mule spindles and substituted ring frames for them.

When the Company was organized, in 1899, the price of spot cotton was less than seven cents.[3] The benefit of this cheap cotton lasted on into 1900, which, with the rising price of finished goods, permitted a liberal margin of profit for the first year. During that year, however, the price of spot cotton rose to an average of nine and a quarter cents, a rise of nearly 50%. This necessitated a corresponding rise in the price of yarn. As a result the knitting mills, believing the high price of cotton could be fully accounted for by the temporary short crop, withdrew from the yarn market until a better cotton crop should presage a fall in the price of yarn.[4] In 1901, however, matters were no better and the average price of spot cotton throughout the

[1] Say above 80's.

[2] The point above which it is wise to operate mules seems to be now about at 70's. Three manufacturers of whom I have made inquiry put it at 60, 70, and 80. Some operators of knitting mills prefer mule spun yarn in the lower numbers and are willing to pay extra for it. This decidedly complicates the question of economy.

[3] The following are the extreme fluctuations in spot cotton for the years considered in this paragraph: —

	High	Low	U. S. Dep't C. of L. Average
1898	6 9/16	5 5/16	5.94
1899	7 13/16	5 7/8	6.88
1900	11	7 9/16	9.25
1901	12	7 13/16	8.75
1902	9 7/8	8 13/16	9.00
1903	13 3/4	8 7/8	11.18

[4] The price of knitted underwear, stockings, and similar material sold directly to a retail trade is not remarkably elastic. The increased price of yarn would, in a large measure, represent a corresponding decrease in the knitters' manufacturing profit. His only alternative would be to decrease his output, which would be retroactive on the yarn mills.

year was again over nine cents. The New England Cotton Yarn Company thus found itself, in the summer of 1901, with a heavy stock of yarn made from "nine-cent cotton," on its hands, but with its customers unwilling to buy except for immediate needs, on account of the high cost. The economies of combination could be obtained only from large-scale production, and large-scale production was suicidal, under the conditions which then prevailed.

Most serious of all, however, was the position of the New England Cotton Yarn Company in the yarn trade. When the consolidation was consummated, it was presumed that the centralized management could introduce important economies, not the least of which would be the concentration of each mill on a special line of yarn. In this way, the mills would be relieved of the expense of shifting the machinery back and forth to meet the requirements of each order. But the old trade-marks of the separate mills covered a wide variety of yarns, and when the Company attempted to furnish yarn made in the Bennett Mill to a customer ordering Cohannet yarn, merely because the Bennett Mill was specializing in that variety, the customer considered himself unfairly treated. When the customer ordered Rotch yarn, he sometimes received yarn from some other mill designated as New England Cotton Yarn Company's Department "11," and was not pleased. The Company was introducing the economies of large-scale production, but was destroying its most valued asset, the individuality of small-scale production, and the loyalty of a special line of customers attached to each mill. It was reported on excellent authority that at one time the Company distributed Cohannet labels to other mills, because of the high standing of the Cohannet yarns, but this deception was soon discovered, and it had the effect of ruining the Cohannet name, without achieving any positive result. This dissatisfaction of the customers [1] proved a most positive force in stimulating competition among competitors. The New England Cotton Yarn Company at no time controlled over 68% of the manufactured yarn sold to other mills. Thus they were

[1] Particularly among the gingham manufacturers.

in no position to dominate the industry. Other yarn mills in New York state and near Philadelphia solicited and secured orders from old customers of the New Bedford and Taunton mills, who were dissatisfied with the treatment they were receiving from the management of the New England Cotton Yarn Company. To aggravate matters, the Company suddenly decided to sell its own yarn without the help of the commission houses. It had been long the custom in the textile trade for a selling house or commission merchant to attend to the sale of the entire product of certain mills, at a regular commission. This commission included not only the services as selling agents, but also the endorsement of the mill's single name commercial paper. So highly regarded is this mill paper with the commission house endorsement that it is a legal investment for Massachusetts Savings Banks, and is held largely by New England trustees, — for example, Harvard College has upwards of $500,000 of its funds in this form of investment. The New England Cotton Yarn Company believed itself strong enough to establish its own selling agencies and distribute its product without the commission merchant's charges. And less than a week before October 1, 1900, the Company sent a circular letter to the commission men, stating they would thereafter sell to their customers directly. Immediately, in order to save their business, the various agents assumed the selling for mills outside of the New England Yarn Company. They induced cloth mills to install finishing machinery and to manufacture yarn incidentally. Soon, too, the commission merchants began to build new yarn mills of their own, and to enlist the investment of southern capital in the manufacture of yarn. In this last named effort, the manufacturers of machinery coöperated very substantially through their willingness to accept southern mill stocks for spinning and twisting frames and other yarn equipment. Thus, although direct selling proved cheaper than the older method, it stimulated new competition to such an extent that the Company suffered severely through the change.

But the ill effect of these various conditions was not felt immediately. It was not until the publication of the statement

of June 28, 1902, that suspicions of unsoundness were aroused. Although it must have been clear to the Board of Directors that dividend disbursements on the preferred stock should cease, dividends were again declared in the winter of 1902–03, in the hope of better earnings as a result of the lower cost of raw cotton. This hope was not realized, for the cotton crop of 1903 was less than that of 1902 by a half million bales, and spot cotton rose rapidly during the early part of 1903. The average price was a little over 11 cents, the highest 13½ cents. Moreover, the published statements had indicated that the failure of the Company to meet expectations was due to the increasing cost of cotton alone, while in reality the fault lay more in the other causes already enumerated, principally in that of management, and no mere fluctuation in the price of cotton would have been able to eradicate the underlying difficulties. Early in 1903, rumors of financial trouble became current, but a Director was quoted as saying that, while all textile companies had suffered from labor troubles and high cotton, he "was sure the Company would pull out all right." [1] The preferred stockholders were assured that the dividend would be paid as usual. A few days after these reassuring publications, the Directors voted not to declare the preferred dividend due July, 1903, "since it had not been earned." [2] A member of the Executive Committee was quoted at the time as saying that the payment of the dividend would make it difficult, if not impossible, to carry the floating debt.[3] Provisions for reducing the floating debt seemed imperatively necessary, and a committee of three[4] was appointed to devise a plan for placing the finances of the Company in a more secure position.

When the rumors of financial difficulties were confirmed by this action of the Board of Directors, the price of the preferred stock fell precipitously from $78 a share in the last of May to $25 a share in the last of June. People came suddenly to believe

[1] 76 *Chron.* 1304.

[2] 76 *Chron.* 1358. See also *Journal of Commerce and Commercial Bulletin*, June 15, 1903.

[3] 76 *Chron.* 1358.

[4] Wm. W. Crapo, N. P. Hallowell, R. M. Saltonstall.

that the difficulty was one of management, not of labor troubles nor of the high price of cotton.

The Company's quick assets had not been managed as conservatively as the traditions of New England textile banking required. In the four years of its history, from July, 1899 to July, 1903, the Directors had paid out $1,212,500 in preferred stock dividends. During this time the money in the treasury had fallen from $2,092,851 to $514,284. The notes payable, which at first were $2,630,666 and had fallen as soon as the Company was on its feet to $650,000, had risen by July, 1903, to $2,042,000. In brief, the relation between cash and bank loans assumed a most unpromising aspect, and the Company found itself, with its credit impaired, still facing adverse business conditions. Had the $1,212,500 paid out in preferred stock dividends been kept in the treasury, there would have been ample quick assets to give support to the Company's commercial paper. It is the frequently told story of lack of conservatism in dividend policy, inspired by an uncritical optimism. The preferred stockholders themselves were really affected adversely, too, for while they received $24.25 a share in dividends, their stock fell in value from $105 to $25 a share. It might seem, at first sight, as if the dividends on the preferred stocks were continued in order to make a market for the stock held by the promoters and the mill interests. All the available evidence points to the belief that this was not the case.[1]

The Committee appointed to consider the rehabilitation of the Company reported that it was advisable:[2]

[1] The mill interests and the bankers held the common stock, but they had never attempted to find a market for it; it was not even listed on the Stock Exchange, and it is impossible to find any public quotation for the shares. The same interests had taken, too, about $3,000,000 of preferred stock but the market for this was narrow, and evidence points to the belief that the same interests continued to hold most of the stock through the depression. The firm of Kidder, Peabody and Company held some 5,000 shares through the reorganization. (Letter of Kidder, Peabody & Co., dated June 29, 1903.) As late as November, 1912, Kidder, Peabody & Co. were the registered holders of 10,307 shares of the preferred stock and 1,255 shares of the common stock of the reorganized Company.

[2] Circular letter of the Crapo Committee, dated June 29, 1903. This letter embodies the plan of reorganization presently to be described.

(*a*) To acquire a charter for a Massachusetts corporation, which should take over the assets of the New Jersey corporation of the same name.

(*b*) To reduce the floating debt by an assessment on the stockholders.

(*c*) To reduce the capitalization, and the cumulative dividend charges.

(*d*) To leave the bonds undisturbed, as the fixed charges had unquestionably been earned.

The plan provided for a reorganization which should bear heavily upon the stockholders. They were required to provide $2,000,000 in new money, which would be represented by new preferred stock, and required to accept a new common stock for their holdings in the old Company. Those who held the preferred shares were assessed $30 a share, and given $70 in new common stock. The holders of the common stock were assessed $10 a share, and given $8 in new common stock, — their interests were reduced from $5,000,000 to $400,000, and to secure this they were compelled to subscribe $500,000. Later it was announced that the preferred stockholders were permitted to buy, for $100 in money, $100 in new preferred stock and $80 in new common stock. These were exactly the terms offered the common stockholders so that, to all intents, the old common stock was entirely extinguished. The ruthlessness with which the stockholders were treated was more remarkable because the reorganization did not follow a default of the bond interest, but was put through by the stockholders themselves.[1] In fact, the common stockholders, who were dealt with in the utmost severity, were the bankers and mill interests through whose efforts the reorganization was consummated. The new preferred stock was to carry 6% non-cumulative dividends. As a result, therefore, the Company was given the use of $2,000,000 in new money, with which to discharge its floating debt; and the cumulative dividend charges were entirely eliminated. It was anticipated that the credit of the Company with the banks would be restored by the consummation of the plan. The investment standing

[1] For references and details see Reorganization Plan, June 29, 1903.

of the Company's stocks, also, would be benefited by the renewed strength and by the fact that they were non-taxable to residents of Massachusetts among whom the stocks were largely held. The details of the reorganization are given in the table on the following page.

The only difficulty lay in persuading the stockholders to come forward with their money assessments.[1] To insure this, Kidder, Peabody and Company formed a syndicate to underwrite the subscriptions.[2] The syndicate members were each to receive 5% for their subscriptions, and Kidder, Peabody and Company were themselves to receive a commission of 5% as managers. The syndicate was empowered to become a purchaser of the bonds, stocks, and notes of the Company. The old stockholders were allowed until July 14, 1903 to deposit their stocks with Kidder, Peabody and Company, but it was clear before that date, that the plan would succeed, as 94% of the preferred and 80% of the common shares had been deposited.[3] On September 2,[4] the stockholders passed a resolution to dissolve the old Company; and on November 27, 1903,[5] the New England Cotton Yarn Company became a Massachusetts corporation. The balance sheet of October 1, 1904 shows the benefits secured by the reorganization. The plant account had been marked down from $13,254,128 to $8,131,120, a book value of the fixed assets which stands very close to their actual value, if we compute the real estate and machinery on a basis of $15 for every spindle in active operation.[6]

One of the chief purposes of the reorganization was to permit an entire change of management. To this end, the former Chairman of the Executive Committee resigned his position to devote

[1] Discussion in newspapers. For example, see *Boston Transcript*, July 10, 1903; *Boston News Bureau*, July 11, 1903.

[2] Syndicate Agreement between Kidder, Peabody and Company and Reorganization Committee of New England Cotton Yarn Company, William W. Crapo, Chairman. Dated June 29, 1903.

[3] 77 *Chron.* 149.

[4] 77 *Chron.* 513.

[5] 77 *Chron.* 2161.

[6] The Company had then nearly 600,000 spindles, although the greater proportion of mules made it uneconomical to operate them all.

	NEW ENGLAND COTTON YARN COMPANY OF NEW JERSEY					NEW ENGLAND COTTON YARN COMPANY OF MASSACHUSETTS									
	Bonds	Fixed Charges	Preferred Stock	Contingent Charges	Common Stock	Assessment		Bonds	Fixed Charges	Preferred Stock		Contingent Charges	Common Stock	
						Indiv.	Aggregate			Perc	Amount		Perc.	Amount
Bonds	$5,263,000	$263,150	....	....	....	....	....	$5,263,000	$263,150	....	....	....		
Preferred Stock	....	....	$5,000,000	$350,000	...	30%	$1,500,000	....	....	30%	$1,500,000	$120,000	70%	$3,500,000
Common Stock	...	...	....	....	$5,000,000	10%	500,000	....	...	10%	500,000	....	8%	400,000
Total	$5,263,000	$263,150	$5,000,000	$350,000	$5,000,000	...	$2,000,000	$5,263,000	$263,150	....	$2,000,000	$120,000	....	$3,900,000

SUMMARY	Old	New	Change Amount	Change Percentage New to Old
Securities bearing Interest	$5,263,000	$5,263,000	....	100%
Securities bearing Interest and Contingent Charges	10,263,000	7,263,000	−$3,000,000	71%
Total Securities	15,263,000	11,163,000	− 4,100,000	73%
Fixed Charges	263,150	263,150	...	100%
Fixed and Contingent Charges	613,150	383,150	− 230,000	62%

all his time to the management of two other mills in which he was interested, and the former President withdrew. The administration was then given over to new men.

The rehabilitated Company was not at first successful. In his report of 1904, President Weld stated that the prevailing high price of cotton had caused customers to close their knitting mills, and that the New England Yarn Company had operated only two-thirds of its spindles.[1] Nevertheless, as the Directors attempted to pay no dividends on the stocks, the Company was able to maintain its position. In the meantime, the new management made extensive improvements in the equipment of the mills, discarding old English mules and substituting the most modern spinning machinery. These changes bore fruit in the following years. The report for 1905 showed net profits of over $500,000, after large replacements had been charged to operating costs.[2] In 1906 the profits were still greater, while in 1907 they amounted to $1,500,000. Meanwhile, dividends had been resumed on the preferred stock, and in the autumn of 1907 an initial dividend of 1½% was declared on the Common Stock.[3] The securities of the Company were first entered on the list of the Boston Stock Exchange in 1905. During the next two years the market price of the preferred stock rose from $80 a share to $90, that of the common stock from $27 to $75.

The serious difficulty that confronted the New England Yarn Company lay in the fact that its product represented only semi-manufactured merchandise. Yarn had no market with any ultimate consumer, it could be sold only to other manufacturers. To create a steady market for its goods, and to reach out toward the ultimate consumer, the old Company had the Howland mill in New Bedford refitted with both spinning and weaving machinery.[4] The new mill was called the Gosnold. All of its common stock was held in the Treasury of the New England Cotton Yarn Company.

The Directors became interested in the knitting business. The "Union Mills" Company was organized in 1901 by

[1] 79 *Chron.* 2204.

[2] 81 *Chron.* 1608.

[3] 85 *Chron.* 225.

[4] 82,232 spindles and 3,250 looms.

interests closely connected with the control of the New England Cotton Yarn Company. Its capitalization consisted of $840,000, $280,000 each of 5% bonds, 6% preferred stock, and common stock. The "Royal Gem Mills" Company was organized by the same interests in 1902, with a capitalization consisting of $600,000, again evenly divided between 5% bonds, 6% preferred stock, and common stock. These mills were all situated in New York state. From their organization, they had been successful, and as the control was identical with that of the New England Cotton Yarn Company, the closeness of relationship of the three corporations resulted in their mutual advantage. In 1909 it seemed wise to extend the operating management of the knitting mills over the plants of the New England Cotton Yarn Company as its success had been conspicuous. The companies controlling the Union and the Royal Gem mills were first merged into a single corporation. Their underlying bonds were liquidated, and the stocks absorbed by a new corporation called "The Union Mills" Company, with $1,500,000 of 6% preferred, and $1,000,000 of common stock. In this amalgamation, $1,440,000 in outstanding capital liabilities was recapitalized for $2,500,000. This increase was explained by the previous success of the mills, which had enabled the management to turn a large part of the earnings back into the companies.[1] The new corporation, "The Union Mills" Company, then leased the New England Cotton Yarn Company, guaranteeing the sinking fund and interest on its underlying first mortgage bonds, together with dividends of 6% on the New England Cotton Yarn Company preferred stock and 7½% on its common stock. In all the Union Mills obligated itself to pay approximately $717,500,[2] on account of the Yarn Company lease, and $60,000 on its own preferred stock. The net earnings of the New England Yarn Company had been

[1] The management valued the plants at approximately $1,400,000 at the time of the lease. The mills had $1,100,000 net quick assets. Letter of New England Cotton Yarn Company's Directors to stockholders, dated January 20, 1913.

[2]

Interest — N. E. C. Y. Co. Bonds (approximately $4,940,000)	$247,000
Sinking Fund (N. E. C. Y. Co. Bonds)	58,000
Preferred Stock dividend (N. E. C. Y. Co. $2,000,000)	120,000
Common Stock dividend (N. E. C. Y. Co. $3,900,000)	292,500
	$717,500

ample to take care of its own charges in the years immediately preceding the lease.[1] During the first year of the lease, ending November 26, 1910, the two companies showed net earnings sufficient to permit the payment of the full charges on the New England Cotton Yarn Company's securities and as well dividends on both preferred and common stock of the Union mills. In addition, the Company created a surplus of $125,000. The market price of New England Cotton Yarn Company's preferred stock had risen to $118 a share, and that of the common stock to $125 in anticipation of the benefits to be derived from the lease. During the succeeding year, the earnings were not so ample, and no dividends were declared on either class of the "Union Mills" Company's stocks.

The year 1912 proved less fortunate for both companies, and it was clear that the combined earnings of all the mills were insufficient to meet the guaranteed charges on the Cotton Yarn Company's securities. The steady decrease of earnings was probably due, at bottom, to the difficulties of managing so large and varied an enterprise. The man operating the Union Mills had been successful in managing a relatively small group of knitting mills, but the detailed management of a large group of yarn mills having upwards of 600,000 spindles and producing a variety of yarns for markets of the most diverse character required different powers. By January, 1913, it appeared that not only was it true that the net earnings of the Cotton Yarn Company and the Union Mills were together insufficient to meet the charges guaranteed by the Union Mills, but, too, in the effort of the latter corporation to carry out the terms of its lease, its own capital had been depleted by $900,000.[2] It was clear that, should the lease be continued, the assets of the Union Mills would become exhausted and its guarantee worthless. In this predicament, the Directors of the two corporations agreed to a cancellation of the lease and a reorganization of the Union Mills.

[1] Details see 89 *Chron.* 1070, 1284, 1355, 1399. For copies of letters of the Presidents of both companies, see 1909 *Am. Wool and Cotton Reports*, 1671.

[2] Letter of Directors of New England Cotton Yarn Company to stockholders, dated January 20, 1913.

A new Massachusetts Corporation was formed which took over the assets of the old Union Mills. This new corporation issued $2,000,000 in first preferred 4% stock, all of which, together with $500,000 in money, was given to the New England Cotton Yarn Company in consideration of the cancellation of the lease. In addition, the new Company issued $1,000,000 of second preferred, 6% stock, — exchanged on an even basis for the old preferred stock, — and $1,500,000 in common stock. The latter was taken by the holders of the old common stock of the Union Mills. The reorganization affords an example of the price a corporation must pay to obtain relief from a burdensome lease. In addition to the loss of a sum of over $900,000, which the Union Mills Corporation had already used to maintain its guarantee under the lease, it now gave $500,000 in money and a prior lien security amounting to $2,000,000 to be relieved of it, a cost amounting in all to $3,400,000. A table affords a brief summary of the reorganization:

	Old Company			New Company			
	Preferred Stock	Contingent Charges	Common Stock	First Preferred	Second Preferred	Contingent Charges	Common Stock
New England Cotton Yarn Company ..	....	....	....	$2,000,000	...	$80,000	
Old Preferred Stockholders	$1,000,000	$60,000	....	....	$1,000,000	60,000	
Old Common Stockholders	...	....	$1,500,000	...	..	....	$1,500,000
Total	$1,000,000	$60,000	$1,500,000	$2,000,000	$1,000,000	$140,000	$1,500,000

SUMMARY	Old	New	Change Amount	Change Percentage
Securities bearing contingent Charges	$1,000,000	$3,000,000	+$2,000,000	300%
Total Securities	2,500,000	4,500,000	+ 2,000,000	180%
Contingent Charges	60,000	140,000	+ 80,000	233%

The financial condition of the Union Mills prior to the lease in 1909 may also be compared with condition of the same mills after they had thrown off the burden of the lease:

	1909	1913
Net value of property	$2,500,000	$1,100,000
Capitalization	2,500,000	4,500,000
Preferred contingent charges ..	60,000	140,000

The history of the cotton yarn consolidation centers about the drastic reorganization in 1903 of the New England Cotton Yarn Company and the equally remarkable reorganization of the Union Mills ten years later. Both reorganizations were the direct results of threatened financial failure, caused chiefly by lack of marked ability in the management. The administration of a small mill is relatively easy. Strict economy and attention to detail is all that is required, and the long history of the New England textile industry has produced many men who are thoroughly equipped and equal to the task. But for the management of a large group of mills, there is required administrative ability of a distinctly different and higher order than that demanded for the management of a single mill, or a small group of mills. It is not only a difference of ability in degree, but in kind. The failure of the New England Cotton Yarn Company in 1903 and of the Union Mills in 1913 was due to a failure to recognize this fact.

APPENDIX TO CHAPTER ON NEW ENGLAND COTTON YARN COMPANY

Balance Sheets, 1899–1911

	July 15, 1899	June 30, 1900	June 29, 1901	June 28, 1902	June 27, 1903	Oct. 1, 1904	Sept. 30, 1905	Sept. 29, 1906	Sept. 28, 1907	Sept. 28, 1908	Sept. 25, 1909
Assets											
Plant, Good-will, etc.	$14,008,255	$13,949,488	$13,872,664	$13,817,867	$13,254,128	$8,131,120	$8,226,074	$8,518,190	$8,498,429	$8,465,891	$8,467,276
Improvements	....	....	318,586	420,264	725,055	....	....	....	....	....	....
Material, raw, in process, and unfinished	1,758,069	2,180,806	3,818,565	3,450,655	2,568,706	2,321,156	2,593,471	2,031,788	2,647,748	2,394,846	3,187,958
Accts. & Notes Receivable	587,681	228,097	336,058	483,069	382,123	653,156	1,317,588	1,521,683	1,167,769	1,509,075	867,753
Investments	76,073	15,950	15,950	15,950	15,950	401,950	412,540	412,540	424,540	419,986	406,236
Cash	2,092,851	472,738	540,575	447,592	514,284	834,293	521,485	907,785	784,218	1,220,366	983,769
Suspense Accounts	....	....	2,503	45,827	27,118	18,295	17,505	2,779	13,894	10,744	18,066
Bonds in Treasury	....	....	....	....	81,000	....	....	....	....	....	....
Gosnold Mill Stock	....	....	....	....	300,000	....	....	....	....	....	....
Renewal Account	....	....	....	....	....	....	....	....	....	....	26,998
Total	$18,522,929	$16,847,082	$18,904,901	$18,681,224	$17,868,364	$12,360,770	$13,088,663	$13,394,765	$13,536,598	$14,020,908	$13,958,056
Liabilities											
Stock, Preferred	$5,000,000	$5,000,000	$5,000,000	$5,000,000	$5,000,000	$2,000,000	$2,000,000	$2,000,000	$2,000,000	$2,000,000	$2,000,000
Stock, Common	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	3,900,000	3,900,000	3,900,000	3,900,000	3,900,000	3,900,000
1st Mortgage Bonds	5,700,000	5,646,000	5,577,000	5,523,000	5,263,000	5,263,000	5,263,000	5,206,000	5,142,000	5,060,000	5,005,000
Notes Payable	2,630,666	650,000	2,947,000	2,632,500	2,042,000	1,158,596	1,670,080	1,493,294	910,794	1,432,795	1,449,023
Accounts Payable	137,799	12,977	63,555	183,463	16,890						
Organ. Expenses	29,939	....	....	....	....	....	....	....	....	....	....
Taxes Payable	24,525	30,750	44,766	24,931	26,349	....	....	....	....	....	....
Interest Accrued	....	117,625	116,188	115,063	109,646	....	....	....	....	....	....
Improvement Account	....	270,347	....	34,475	....	....	....	200,000	....	....	....
Profit and Loss	....	119,383	153,890	158,784	84,057	1,575	231,830	510,230	1,085,215	1,396,767	1,323,851
Suspense Account	....	....	2,502	9,008	26,421	37,599	23,753	27,616	51,362	52,378	45,480
Endt. on Note	....	....	....	....	300,000	....	....	....	....	....	....
Reserve for Depreciation	....	....	....	....	....	....	....	57,625	116,358	178,968	234,702
Dividends on Common	....	....	....	....	....	....	....	....	175,500	....	....
Renewal Account	....	....	....	....	....	....	....	....	155,369	....	....
Total	$18,522,929	$16,847,082	$18,904,901	$18,681,224	$17,868,364	$12,360,770	$13,088,663	$13,394,765	$13,536,598	$14,020,908	$13,958,056

1911 — N. E. C. Y. Co. & Union Mills accounts not separated.

CHAPTER XIII

THE EARLY HISTORY OF THE COTTON DUCK CONSOLIDATION

The duck business and its history, 335; the promotion of the Mount Vernon-Woodberry Cotton Duck Company, 337; financial aspects of the promotion, 339; value of the mill property, 342; success of the Mount Vernon-Woodberry Company, 344; plan for the further extension of the consolidation, 347; the United States Cotton Duck Corporation purchase money syndicate, 349; the plan of rehabilitation of the Mount Vernon-Woodberry Company, 350; early history of the United States Corporation, 354; the unsuccessful attempt to consolidate the two companies, 356; the Consolidated Cotton Duck Company, 361; results achieved by the formation of the Consolidated Cotton Duck Company, 364; acquisition of the J. Spencer Turner Company, 365; decrease of earnings following 1906, 368; summary of reasons for the failure of the cotton duck consolidation, 373.

CHRONOLOGICAL SUMMARY

1899. Promotion of Mount Vernon-Woodberry Cotton Duck Company.
1901. Formation of United States Cotton Duck Corporation.
1903. Unsuccessful attempt to completely merge the two companies.
1905. Formation of the Consolidated Cotton Duck Company.
1906. Acquisition of the J. Spencer Turner Company.
1909. Business of the mills results in large deficit.

THE only consolidation of cotton manufacturing companies promoted in the period from 1897 to 1903, besides the New England Cotton Yarn Company, was organized in the duck branch of the business. In the general character of the experiment the combination of yarn and of duck industries had much in common. In both cases there were no natural restraints to the free erection of small mills, nor to the free purchase of raw material; there were no special advantages in the process of manufacture, nor in the sale of the product.[1] The successful

[1] One difference between the two branches of the textile industry should be noted. Cotton duck is the only fabric which can be manufactured more cheaply in the United States than abroad. Especially is this true of the coarser ducks, where the direct labor costs are proportionally small, where the machinery is heavy and somewhat cumbersome, and the skill of the operatives comparatively slight. That, with the exception of the Yarn Company, the only large industrial con-

manufacture of duck, quite as much as that of yarn, can be reduced ultimately to skill of administration, and the success or the failure of the duck consolidation, like that of the New England Yarn Company, depended almost solely upon the possibility of obtaining a management capable of directing a large group of mills as wisely and economically as the average operator could direct a small independent mill. In this essential particular, the duck mills failed. After a year of conspicuous success, the attempt was made to maintain high prices through extension of control over other mills. This proving without avail the consolidation passed, in rapid succession, through one unsuccessful attempt, and three successful attempts at reorganization. The first two reorganization plans were intended to correct the financial blunders of the promotion period, and the last two were advanced as means of supplying new capital and new management at times when the Company was in difficulties. Looked at as a whole, the cotton duck consolidation presents perhaps the most intricate, complex, and disorganized operating history of any of the industrial consolidations promoted in the period following the depression of the nineties.

Coarse cotton fabrics, or ducks, are used for a great variety of purposes, and their manufacture extends over a century. One of the earliest uses was in the manufacture of sail cloth and tents. Ducks and drills of various degress of fineness form the basis of rubber hose, rubber shoes and rubber blankets. A great deal of duck is used in the construction of heavy harvesting machinery. Latterly an industry of considerable magnitude has grown up for the manufacture of a coarse fabric, — the best of it made from sea island cotton, — out of which automobile tires are made. The weaving of sail duck was one of the first textile industries established in this country. As early as 1788, the Massachusetts Legislature granted a bounty of eight shillings per piece of thirty yards by twenty-eight inches, to "encourage the manufacture of sails at home." That same year, on the

solidation effected in the cotton industry occurred in that branch where a protective duty on imported fabrics is least necessary, is a fact in opposition to the slogan, "The tariff is the mother of trusts."

strength of the bounty, Jonathan Amory and others established in Boston a small sail cloth factory. The capital was $6,000.[1] The industry grew rapidly, stimulated by the prosperity of the early shipping business. During the latter part of the nineteenth century, duck mills were established in the south, nearer the sources of raw material, and Maryland became the center of the industry.

As early as 1884, a "gentlemen's agreement" had existed among the duck manufacturers to restrict their output. At first this agreement was very loose, and accomplished little in the way of a control of the market. Gradually the "understanding" among the mill owners became more precise, and by the early nineties, it had reached the form of a definite pooling agreement. At first, there was a Cotton Manufacturers Association, and later a Cotton Duck Manufacturers Association. These pooling agreements were very informal in character. Each mill was assigned its output, and expected to keep within the limit. Those manufacturers who exceeded their assigned production paid into "the pool" a certain number of cents per pound of over-production; those that fell below were paid by "the pool" proportionately.[2] As in the majority of such agreements, there was always friction caused by alleged dishonest methods of conduct. Frequently, the extreme anxiety of salesmen to make sales led to practices which broke the spirit, if not the letter, of the pooling agreements. At one time, it was proposed to introduce a system of fines for bad faith, but the plan was never adopted. Competition in the middle nineties was so severe that the agreements were of little value in maintaining the stability of the market.

[1] President Washington visited this sail cloth factory and made the following memorandum in his note book.

"They have 28 looms at work and 14 girls spinning with both hands, the flax being fastened to the waist. Children turn the wheels for them, and with this assistance each spinner can turn out 14 pounds of thread per day, when they stick to it, but, as they are paid by the piece for the work they do, there is no other restraint upon them to come at eight o'clock in the morning and return at 6 in the evening. They are the daughters of decayed families, none others are admitted."

[2] The operation of such a pool is referred to previously, p. 75, p. 114. For further references, see page 115, note 1.

Beginning about 1895 or 1896, several manufacturers of cotton duck began to consider the feasibility of a combination of mills. The movement amounted to little, because of the jealousy among the manufacturers. In the autumn of 1898 the question of consolidation was again proposed. The earlier movement had been managed by the mill owners themselves, while this one was put forward by a New York promoter named John H. Parks. Back of him stood men associated with the J. Spencer Turner Company, a prominent commission house, and other New York capitalists. Parks came to Baltimore and easily interested nearly all the prominent duck manufacturers of the vicinity of Baltimore.

The promoters even allowed each mill owner to fix his own money price for which he would dispose of his mill. In this way, the promoters secured options on a group of five mills in Baltimore County owned by the Hooper family, and a few smaller mills situated elsewhere. The price agreed upon with one manufacturer was not known to the others. The largest producers of duck, however, the Cromwells who owned the Mount Vernon Mills, were skeptical of the whole consolidation, and demanded a fictitious price. After repeated conferences they agreed to dispose of their properties to the consolidation for a price known generally to be higher than that offered to the other operators. On July 1, 1899, the promoter entered into a preliminary arrangement with a syndicate managed by the Continental Trust Company to which some of the manufacturers agreed to subscribe.[1] The details of this syndicate will be discussed later.

With the Mount Vernon Mills, the promoters felt secure in the development of their plans, and about the middle of July, 1899, it became generally rumored that the consolidation would succeed. The promoter, Parks, kept his name in the background,

[1] Among the Baltimore men whom Parks interested in the plan of consolidation was Henry A. Parr, a Baltimore grain merchant. He was a Director of the Continental Trust Company, Baltimore, and in his zeal to secure business for his Trust Company he induced the promoters to offer the underwriting to the Continental Trust Company. The latter has sometimes been represented as the promoter. This is apparently false, as the project, — even to the financial plan, — was formulated by Parks and the mill owners before it was presented to the Trust Company.

but in the published announcement it was stated that, "The Continental Trust Company of Baltimore is completing plans for the consolidation of 14 cotton duck mills, which it is claimed produce 90% of all the cotton duck made in the United States." [1] The consolidation was called the Mount Vernon-Woodberry Cotton Duck Company; and subsequently a charter was obtained from the state of Delaware.

The mills of the Company had in active operation about 225,000 spindles, all engaged in the manufacture of medium and coarse duck. Of the fourteen mills, the four owned by the Mount Vernon Company were distinctly the best equipped and for them the promoters paid highest. The five Woodberry Mills, owned by William E. Hooper and Sons, were the next best and the lowest price was paid for them. The Tallassee Falls Manufacturing Company owned a large southern mill of 76,200 spindles. The Laurel Mill, a small one, had never paid and the owner [2] had himself acquired it from the previous owners at one-fourth of its capital valuation. The Columbia Mills were of medium size, of thoroughly modern construction and in an excellent state of repair; they were sold to the Mount Vernon Company at approximately $80 a spindle, while they had cost less than one-half of this.[3] The Greenwoods Company [4] owned a mill at New Hartford, Connecticut, the only New England mill in the combination. It was controlled by the J. Spencer Turner Company, a large commission house, and was taken into the consolidation at an excessive figure, because of the close connection of the Turners.[5] The small

[1] 69 *Chron.* 129, July 15, 1899. Also see notices in trade journals as, 1899 *American Wool and Cotton Reporter*, 974. Also alleged to the subscribers of the original syndicate.

[2] David H. Carroll.

[3] The statements in this paragraph covering the conditions and capacities of the constituent mills of the consolidation were made on the testimony of two mill owners familiar with the promotion.

[4] The Greenwoods and Franklinville Mills were subsequently closed and dismantled.

[5] In reference to the too liberal terms offered the Turners, the promoters alleged "The coöperation of the Turners was of great importance to the Mount Vernon-Woodberry Cotton Duck Company as they or their friends owned or controlled

mill at Franklinville, Maryland, was of insignificant importance. The following table gives a brief summary of the mills acquired by the Mount Vernon-Woodberry Cotton Duck Company: —

Company	Owners	Mills	Active Capacity (Spindles)	Location
Mount Vernon Co.	Cromwells	Mill No 1	55,100	Baltimore, Md.
		Mill No. 3		Baltimore, Md.
		Druid Mill		Baltimore, Md.
		Phoenix Mill	1,500	Baltimore Co , Md.
Woodberry Manufacturing Company	Wm. E. Hooper and Sons	Woodberry	38,272	Baltimore, Md.
		Clipper		Baltimore, Md.
		Meadow		Baltimore, Md.
		Park		Baltimore, Md.
		Mount Washington		Baltimore, Md.
Tallassee Falls Manufacturing Co.	Various	Tallassee Mill	76,200	Tallassee, Ala.
Laurel Mills	Carroll	Laurel Mill	8,956	Laurel, Md.
Columbia Mills	Oliver	Columbia Mills	32,000	Columbia, S. C.
Greenwoods Company	Turners	Greenwood Mill	12,000	NewHartford,Conn.
Franklinville Mills	Jones	Franklinville Mill	1,500	Franklinville, Md.
Total spindles			227,028	

Both the Mount Vernon[1] and the Woodberry Companies had old, well established businesses with valuable trade-marks.

In the printed announcement of the consolidation, as has been quoted, it was stated that the mills of the Company produced 90% of all the duck made in the country.[2] This was undoubtedly an exaggeration. A more reasonable estimate would have placed their control of the medium and coarse ducks at between 70% and 80%. If the fine ducks and drills were included in the estimate, their control of the entire industry was probably very much less.

When we turn to the financial aspects of the promotion, we are confronted with a strange mixture of stupidity and com-

the Tallassee Falls Manufacturing Company of Alabama and the Greenwoods Company of Connecticut. . . ."

"The Turners individually subscribed large sums to the syndicate and through their friends procured other large subscriptions thereto. . . ."

The stockholders of the Turner Company (J. Spencer Turner, Thomas M. Turner, E. A. Brinckerhoff, and S. M. Lehman) subscribed to the underwriting syndicate "to an aggregate in excess of $500,000." Whitridge *et als.* *v.* Mount Vernon Cotton Duck Co. *et als.*, Circuit court of the United States for District of Maryland. Answer of defendents, filed 1909, pages 25, 26.

[1] The Mount Vernon Mills had been established in 1848.

[2] Page 338.

plexity. With the exception of certain small mortgages, the mills were free and clear of indebtedness. Upon them the promoters of the enterprise placed a first mortgage of $8,000,000 under which bonds to the amount of $7,000,000, were immediately issued. In addition to this, they added $6,000,000 of income bonds, secured by a second mortgage on all the fixed assets, and a direct lien on all the merchandise and quick assets. After these two issues of bonds, the Mount Vernon-Woodberry Cotton Duck Company created stock to the amount of $9,500,000. It is a universally recognized principle of finance in the textile industry that no permanent mortgage should be placed on a mill property, because mills are always borrowers of banks, in order to carry their heavy stocks of raw material and finished goods.[1] In other words, banks will loan to mills on better terms if all their tangible assets are free and clear of underlying indebtedness. In the face of this simple principle, the promoters of the cotton duck consolidation resorted to a heavy first mortgage, followed by a second mortgage which embraced every form of asset likely to come into the possession of the corporation. Income bonds have seldom been used in industrial promotions. Even income bonds of railroad corporations invariably owe their existence to periods of depression and reorganization. The financial plan of a cotton mill consolidation would be the least reasonable place to look for income bonds, and yet this is the only important instance where they appear among securities created at the time of an industrial promotion.[2]

The money offered the owners of the separate mills was furnished by a syndicate managed by the Continental Trust Com-

[1] Previous reference to this principle in the case of the New England Cotton Yarn Company, p. 108. It appears, from what evidence the present writer can gather, that it had become the fashion in 1899 for Baltimore promotions to employ bonds, — and income bonds were very common. The responsibility for this wrong plan of capitalization rests squarely on the shoulders of the promoters and mill owners.

[2] The report of the Reorganization Committee, S. Davies Warfield, Chairman, of the Mount Vernon-Woodberry Cotton Duck Company stated, "The existence of the Income Bonds secured by mortgage on its property seriously impairs the credit of the Mount Vernon Company." Plan prefixed to the Reorganization Agreement of May 8, 1905.

pany. The Parks syndicate bought the securities paying \$11,275,000 in money for the \$7,000,000 of first mortgage bonds, the \$6,000,000 of income bonds and \$3,250,000 in stock. In this computation it appears that the first mortgage bonds were valued at 92½%, the income bonds at 80%, and the common stock was given as an extra bonus. The Trust Company was appointed agent in the syndicate agreement to sell the first mortgage bonds for par and the income bonds for 85% any time before July 1, 1901, and the syndicate was to expire by limitation March 1, 1900. Many of the mill owners were subscribers to this syndicate, partially or wholly to the extent of the money to be paid them for their property.[1]

After delivering the stocks and bonds to the syndicate manager the promoters had remaining in their hands \$6,250,000. This was the promoters' profit, after the initial expenses of organization had been met. The stock first sold for \$30 a share, but this level was not long maintained. Considering the money value of the stock at least \$25 a share, the promoters' profit was approximately \$1,500,000.[2]

The Parks syndicate acquired the mills for approximately \$50 a spindle. Engineers have told the writer that at the time

[1] It appears that when Parks and his associates, the mill interests, presented the plan to the Continental Trust Company to secure their services, the promoters had arranged with the mill interests that some 60% to 70% of the requisite money should be subscribed by the mill owners. That is, it was agreed that the money which they should ostensibly receive for their mills would be immediately paid back into the syndicate, — they taking bonds and stock as any other of the underwriters. It appears that the remainder, about \$4,000,000, was subscribed in cash by the public. The Continental Trust Company participated to the extent of approximately a half a million dollars and the Directors also subscribed on their own account. As in the majority of industrial underwritings organized in the period from 1897 to 1902, it was regarded as a privilege to be allowed to subscribe as the financial world anticipated an assured profit in every case. The subsequent litigation over the income bonds shows that the Colonial (then the Real Estate) Trust Company subscribed to the extent of \$112,750, and some of its Directors made personal subscriptions.

[2] This promoters' bonus of common stock was divided among Parks, Parr and the various mill owners. Most of those who had received this common stock from the promotion fund were the active operators of the mills, and believed in the success of the consolidation. They not only kept, in the majority of cases, their original allotments, but purchased common stock on the market from their more skeptical associates. Their ultimate losses were considerable.

in question, 1899, fully equipped cotton duck mills of highest efficiency could be built for $45 a spindle.[1] Assuming the active capacity of all the mills in the Mount Vernon-Woodberry Cotton Duck Company as approximately 225,000 spindles, new and thoroughly equipped mills could then have been built for approximately $10,000,000. The mills of the consolidation were certainly not worth this, as many of them were old, and several were soon abandoned and subsequently dismantled. If we estimate their value at $7,000,000 our figure is probably too high rather than too low.[2] The trade-marks were of very great value and certain small branch railroads belonging to the southern mills had a replacement value of $100,000 to $200,000. The village properties were worth, probably, at least $500,000, but the Tallassee Falls Mill had an underlying mortgage of $250,000. The net quick assets were largely, if not entirely, offset by loans and contingent liabilities. Taking into consideration all these various circumstances, it is perhaps fair to estimate the actual value of the entire property acquired by the Mount Vernon-Woodberry Company at $8,000,000.[3] Against it, the promoters

[1] Readers accustomed to a capitalization of $16–$20 per spindle for medium and fine goods mills should remember that the machinery for the making of duck and coarse goods is heavy and costly.

[2] It has been found very difficult to discover the exact money prices called for by the options on the mills. They were secret and only unreliable rumors were circulated. That they were excessive there is every reason to believe from the evidence available.

Referring to the prices paid by the syndicate for one mill Judge Rose comments, "The mill in question for the six years preceding the organization of the Mt. Vernon never paid a dividend. One of three per cent was paid by it a few days after the Mt. Vernon was incorporated and a few days or a few weeks before it was transferred to the latter company. It cost the Mt. Vernon $237.50 for each $100 share of its stock." Whitridge *v.* Mt. Vernon. Opinion of District Judge Rose. (Opinion quoted in *Baltimore Daily Record*, January 14, 1914.)

[3] This estimate of $8,000,000 has been checked by the two following lines of evidence, in addition to that used in the text. (1) An independent cotton duck manufacturer stated that the opinion of the trade in 1899 was to the effect that "all the assets" acquired by the Company were worth just the $8,000,000 of first mortgage bonds." (2) A manufacturer stated to the writer that he believed the total property of the Company to be worth $35 a spindle as a "full value." This was $7,875,000.

Extravagant claims of replacement value were made, subsequently, by the management quoting the report of the Chartered Accountants, Barrow, Wade,

of the Company issued mortgages to the amount of $13,000,000 and a total amount of securities equal to $22,500,000. The first mortgage bonds involved fixed charges to the amount of $350,000, or approximately $1.50 a spindle. The income bonds, if their interest warrants were regularly paid, required $300,000 more. The fixed and the contingent charges were, therefore, $650,000 or about $2.80 a spindle. Considering the earnings during the early part of 1899, when unusual prosperity prevailed throughout the textile industry, this fixed and contingent charge could not be looked upon as extravagant. In fact it developed later that in the first six months of 1899, the mills, as separate and competitive units, had earned $593,703,[1] or at the annual rate of over $1,100,000,[2]— equivalent to $5 a spindle. In the size of the consolidation, the approximate value of the mills and the earning power at the time of the promotion, it is apparent that the Mount Vernon-Woodberry Cotton Duck Company resembled in many respects the New England Cotton Yarn Company.

The stock of the Company was not distributed until April, 1900,[3] and the bonds of both classes were pooled, so that it is difficult to determine even an approximate market value for the Company. When first quoted the stock had a steady market, with the price ranging in the neighborhood of $30 a share. Counting the bonds as worth the price at which they were obtained by the syndicate, a price by no means high con-

Guthrie, and Company of New York: "We certify that a safe and conservative estimate for the duplication of the several mill properties of the Mount Vernon-Woodberry Cotton Duck Company, to the best of our information and belief, is $12,000,000 and $1,000,000 for the replacement of the villages, etc."

See also latter part of note 2, p. 368.

[1] 71 *Chron.* 345.

[2] The earnings immediately before the combination were relatively high. "The reports of the experts averaging the net earnings for a number of years show, it is said, in addition to the interest on the above bonds, a dividend on the stock." — 69 *Chron.* 129, July 15, 1899. This would have indicated average earnings "for a number of years" in excess of $650,000 a year. In all probability the aggregate earnings of the constituent mills were, at the time, well above this figure.

[3] "The Continental Trust Company is distributing the certificates of stock among the members of the underwriting syndicate, together with the 1½ % dividends for the three months ended December 31." 70 *Chron.* 689, April 7, 1900.

sidering the admirable showing made by the Company during its brief life, we may assume that the Mount Vernon-Woodberry Cotton Duck Company had a market valuation of approximately $13,000,000.[1]

As soon as the Company had been organized Parks, the promoter, withdrew and Richard Cromwell of the Mt. Vernon assumed the presidency.[2] S. Davies Warfield became the Chairman of the Board of Directors, and, from the first, directed the financial management of the Company. His position as President of the Continental Trust Company was one of prominence in Baltimore, but he had had no practical experience in the manufacture of textile fabrics, and knew little concerning the detailed administration of a cotton duck mill.

The Mount Vernon-Woodberry Company was successful at first. At the stockholders' meeting[3] of January 10, 1900, a statement was submitted which "showed net earnings for the four months ended December 30, 1899, of over $600,000.[4] The Directors unanimously resolved to declare a quarterly dividend of 1½%, payable March 1. The Company's annual fixed charges

[1] As the bonds of both classes were pooled it is impossible to determine their actual market value. The first reported quotations were not until June, 1902. At that time the First Mortgage Bonds had an initial price of 82 % and the Income Bonds, 47 %. Prior to these quotations the Company had endured good and bad years, so they reflect but little what would have been the market value of the bonds two years before.

[2] The following gentlemen constituted the first Board of Directors. The interests they represented are indicated for reference. Rich. Cromwell (Mt. Vernon); W. Kennedy Cromwell (Mt. Vernon); James E. Hooper (Woodberry); Theodore Hooper (Woodberry); David H. Carroll (Laurel); Andrew D. Jones (Franklinville); Charles K. Oliver (Columbia); Thomas M. Turner, and J. Spencer Turner (Selling Agents and Greenwood); Michael Jenkins (Mt. Vernon); E. A. Brinckerhoff (Turners); G. K. Sheridan (Selling Agents); F. T. Carpenter (Columbia); Henry A. Parr and S. Davies Warfield (Continental Trust Co.); S. M. Lehman (Bankers); W. K. Boone (Mt. Vernon).

[3] The stock had not been distributed by the underwriting syndicate, so the meeting was little more than a conference of the directors and underwriters. It had been proposed not to dissolve the underwriting syndicate until March 1, 1900.

[4] In the United States Cotton Duck Company purchase money syndicate agreement it was stated to be $609,433.72. Syndicate Agreement of May 1, 1901. Subsequent developments indicated that this amount was probably excessive. The authority for this statement was derived from a letter from Barrow, Wade, Guthrie and Co., dated February 18, 1900.

amount to $350,000, being 5% on its $7,000,000 first mortgage bonds. The Directors voted to set aside $100,000, being four months' interest at 5% on the $6,000,000 income bonds. The Company's officials calculated that, taking the last four months as a basis of operation for the year, after paying the annual fixed charges, and the interest on the income bonds, $650,000, there will be $1,150,000 applicable to the stock or surplus account. The capital stock is $9,500,000 and the dividend just declared is on the basis of 6% per annum." [1] The Company was, at the time, making manufacturing profits at the rate of $1,800,000 a year, — at the rate of 22% on the invested capital. At the meeting of the Board of Directors, on August 15, 1900, a report was presented for the first half of the calendar year. Net manufacturing profits were shown to be in excess of $750,000, or at the rate of $1,500,000 a year. The Company had not quite earned $1,800,000, as the Directors had been led to prophesy six months before, but the earnings were fully as encouraging as the most optimistic of promoters could have hoped. After the payment of interest charges on both classes of bonds, and 2% as a semi-annual dividend on the stock, the Company carried forward a balance to surplus account of $244,380, or nearly one-third the net manufacturing profit.[2]

The earnings of the cotton duck consolidation during the second half year of 1900 were poor compared to those of the previous period. It is undoubtedly true that the period of pronounced activity and liberal earnings, in the midst of which the Company was promoted, and which extended over the first year of its history, was largely due to the business activity "consequent upon the Spanish American War." [3] And, more-

[1] 1900 *American Wool and Cotton Reporter*, 74. Also quoted in part 70 *Chron.* 127, January 20, 1900.

During this period the stock was still held by the syndicate and the bonds had been pooled with the Continental Trust Company.

[2] For detailed summary of earnings of Mount Vernon-Woodberry Cotton Duck Company, see page 377.

[3] This idea was very succinctly expressed by the Reorganization Committee (S. Davies Warfield, Chairman) of the Mt. Vernon-Woodberry Cotton Duck Company. "During the early period of the existence of the Mt. Vernon Company the profits were unusually large, presumably caused by the demand for the product

over, it is doubtful whether the earnings were as liberal as the published statements seemed to indicate. During subsequent litigation independent auditors, taking into consideration decreases in the value of inventories, and depreciation of the plants, estimated the net earnings of the calendar year 1900 to be $603,673,[1] instead of $1,103,673 [2] as the Directors believed. At all events, with the spring of 1901 the management of the Mount Vernon-Woodberry Cotton Duck Company faced conditions of extreme seriousness. Not only were the earnings of the Company falling with increasing rapidity, but the entire market for the Company's fabrics threatened to become demoralized. The suddenness of the depression was as alarming as its rigor. During the last six months of 1900, the net manufacturing profit was over $350,000; during the first six months of 1901, the business was conducted with a manufacturing deficit of $200,000 and a net deficit, after charges were paid, of $375,000.[3] The difference in profit and loss for the closing period of 1900 and the opening period of 1901 was over $550,000. Only the year before the manufacturing profit was estimated at the rate of over $1,500,000 a year. A very large part of this loss was to be explained by the fact that the President, — who controlled absolutely all phases of the mill operation, — had made unwise speculations in cotton. A steady and substantial rise in the price of the raw staple confronted him with his contracts uncovered. Few instances exist of more abrupt and pronounced fluctuations in the earnings of a large industrial enterprise.[4]

consequent upon the Spanish-American War." Plan prefixed to the Reorganization Agreement of May 8, 1905.

[1] Merchants Trust Company of New York *v.* Continental Trust Company of Baltimore. Bill of Complaint, Section 25. (U. S. District Court, Southern District of New York; Bill of Complaint filed September 1, 1904.)

[2] The earnings published at the time were slightly in excess of this figure (page 377).

[3] These figures were never published. They are deduced from evidence stated in one of the later plans of reorganization. For further discussion see footnote 2, page 377.

[4] The nearest approach is probably the abrupt fluctuations in the net earnings of the railroad equipment companies.

The condition confronting the Mount Vernon-Woodberry Cotton Duck Company was not, however, generally known in the spring of 1901, although it was rumored that the conspicuous success of the first year was not maintained.[1] Any falling off of earnings could be explained by the general trade conditions throughout the whole textile industry, conditions by no means as encouraging as those prevailing during the two preceding years. But the management of the Company saw clearly, there is every evidence to believe, that two things were imperatively necessary in order to restore the previous success, — a recasting of the financial structure of the Company, and an extension of its influence over a wider sphere of the industry.[2] These ends were to be accomplished by a reorganization which involved the merging of the mills already controlled with those of certain competitors, an extension of the means for the distribution of the products of the consolidation, the ultimate extinction of the income bonds of the Mount Vernon Company, and the coalition of all interests in a new corporation, with a simpler financial plan. The reorganization was partially successful in the first two objects, but failed in the last two.

The most important of the new mills the management proposed to acquire was the Stark group in Manchester, New Hampshire.[3] They manufactured a medium grade of fabrics

[1] The general feeling of skepticism is shown by the fact that the stock, which had an initial quotation of $30 a share, June, 1900, had declined to $21 a share by January, 1901, in spite of the very favorable statements.

[2] Competition had been stimulated by the success of the combination. The Stark Mills at Manchester, New Hampshire, — presently referred to in the text, — were gradually shifting over from tent and the finer grades of duck to the coarser grades manufactured by the Mount Vernon-Woodberry Company. A similar change was contemplated, — and partially effected, — at Wellington, Sears and Company's West Point, Georgia, mills. A similar tendency was apparent among some of the smaller mills.

[3] Six mills made up of eleven buildings from three to six stories high. Total active capacity about 80,000 spindles of which about a third were mules. Power, steam, 2,200 h. p. and valuable water rights on Merrimac River with 1,800 h. p. developed.

A somewhat doubtful attitude was expressed by one of the textile journals at a later date. "The Stark Mills of Manchester, New Hampshire, which is an extensive water-driven property, organized in 1832, and which, at the time of its acquisition by the Consolidated Cotton Duck Company, was an inefficient property, due

under the well-known *Stark* trade-mark. Through the excellent management of Mr. T. Jefferson Coolidge, the mills had been profitable, and a liberal surplus had been laid aside. The capital stock amounted to $1,250,000 in shares of $1,000 each. During the preceding years, 6% in dividends had been paid, and the market price had ranged from $850 a share in 1898, to $975 in March, 1901; it had not been above $1,000. To acquire this property, the management of the Mount Vernon-Woodberry Company authorized Kidder, Peabody and Company, of Boston, to purchase the stock for $1,500 a share.[1] The offer was immediately accepted by practically all the stockholders. The cost to the new Company was, including the commission, approximately $1,900,000.[2] In addition the management acquired outright two smaller mills of 5,000 and 10,000 spindles at La Grange and Hogansville, Georgia.[3] It also entered into a contract with the owners of a group of mills at West Point, Georgia, known as the Boynton group,[4] to operate the mills until January 1, 1903, with the privilege of purchase. A dividend

to the antiquated machinery it contained and because it did not represent a well-balanced producing unit for the various classes of goods produced by it. It at that time boasted 81,000 spindles, of which about 25,000 were mule." (1913 *Am. Wool and Cotton Reporter*, 802.) The operation of so large a proportion of mule spindles, on the type of yarn used by the cotton duck consolidation, was at the time inexpedient and grew more so as the machinery became relatively more antiquated and the cost of labor higher.

[1] Letter sent to stockholders of the Stark Company, under date of May 10, 1901. It was stated that T. Jefferson Coolidge advised the stockholders to accept the offer. 72 *Chron.* 940.

[2] The machinery of the mill was in poor condition. Considering the size, upwards of 80,000 spindles and the water privilege, it was probably worth about $16 a spindle or $1,280,000. The Stark trade-mark was, however, very valuable.

[3] Although these mills were small, their management was strong. They were acquired largely to stop competition.

[4] The West Point Manufacturing Company,
The Riverdale Cotton Mills,
The Lanette Bleachery and Dye Works,
All at West Point, Georgia.

The West Point mills had previously manufactured a class of goods not similar to that made by the Mount Vernon-Woodberry Company, but, stimulated by the success of the latter, Wellington, Sears & Company, who managed the properties, were gradually shifting on to duck. By the terms of the option, they agreed not to increase the looms working on duck.

of 10% or $95,000 was guaranteed on the stock of the mills.[1] Besides acquiring these mills, the management was able to arrange a contract with a new selling agent, Wellington, Sears and Company of Boston,[2] who, with the J. Spencer Turner Company, and Catlin and Company, undertook to dispose of the entire output of the consolidation. In addition to the extension of the selling agencies, commissions were reduced from 5% to 3%.[3]

In order to obtain the money requisite to pay for the new mills and to organize the new Company, the Continental Trust Company of Baltimore, which had managed the previous syndicates, formed a new syndicate, with itself as manager, to furnish $2,945,000, in money[4] in return for $3,100,000 in the preferred stock and $1,550,000 in the common stock of the new consolidated Company. The Continental Trust Company received a commission of 1% on the par value of the stock sold for the account of the syndicate, and reserved for itself the right of par-

[1] It developed later that $75,000 was set aside from the money received by the underwriting syndicate as a reserve against the guarantee. Merchants Trust Company *v.* Continental Trust Company, Bill of Complaint, section 27.

The West Point mills had previously paid 8%. The additional 2% was the inducement offered the stockholders to consent to the agreement.

[2] Wellington, Sears and Company handled independently the products of the West Point mills not competing with those of the Mount Vernon-Woodberry mills.

[3] "Under the plan for acquiring and operating the above properties, sales agents' commissions will be reduced from 5% to 3% with the usual guarantees and in addition to the agencies through which the Mount Vernon-Woodberry Cotton Duck Company have placed its goods, the well-known commission house of Wellington, Sears and Company (Successors to N. Boynton & Co., Boston, Mass.) will handle, together with the other agents, the products of the mills." Syndicate Agreement, May 1, 1901.

[4] The distribution of the money was to be probably approximately as follows. As only $2,750,000 of the preferred stock was issued it is presumed that something like $250,000 less money was obtained. That being the case some of these items were actually somewhat less. Some of the common stock not accounted for in the table, page 353, was also issued in acquiring the mills.

Stark mills at $1,500 a share	$1,875,000
Expenses and Commission in connection with purchase of Stark Company's Stock	25,000
Purchase of La Grange and Hogansville mills	800,000 (?)
Guarantee to West Point mills	75,000
Incidental expenses	120,000
	$2,945,000

ticipation.[1] In addition to the formation of the syndicate, the Continental Trust Company issued a circular [2] on June 19, 1901, to the members of the Mount Vernon-Woodberry First Mortgage and Income Bond syndicate, asking to have the pool extended to Janaury 1, 1902. It would otherwise have terminated July 1, 1901. By the terms of the extension, the managers were empowered to either sell the bonds or exchange them into the preferred stock of the new Company. The first mortgage bonds were to be exchanged at par, and the income bonds at 83⅓% of their par value,[3] into 6% preferred stock of the new company. The stockholders of the Mount Vernon-Woodberry Company were offered the privilege of changing their stock into the common stock of the new company at 66⅔% of its par value.

[1] The representations upon which the Continental Trust Company of Baltimore solicited participation in the syndicate were subsequently the subject of litigation. Two New York banks, — the Merchants Trust Company and the Central National Bank, — subscribed to the syndicate to the amount of $300,000. They refused to accept the losses and sued the Continental Trust Company in the United States District Court. Two individuals representing claims of $30,000 also participated. In the bills of complaint, filed Sept. 1, 1904, in the Southern District of New York, the plaintiffs alleged that they had been led into making the subscriptions to the syndicate by fraud and misstatements contained in the circular of May 1, 1901. It was alleged that the mills were not worth what they were represented to be, were not earning what had been stated, that certain pertinent facts, — for example, a floating debt of $1,000,000 and the underlying mortgages on certain of the mills, — were not stated; and that the Continental Trust Company through the ownership of $1,000,000 of income bonds was especially favored by the terms of exchange into the new securities. These and other allegations were denied by the Continental Trust Company in its answer filed October 1, 1904. The causes never came into court. At first the Continental Trust Company offered to settle for 60% of the claims. This the plaintiffs refused. Subsequently, at the time of the next reorganization, Samuel Untermyer, as attorney for the Reorganization Committee, agreed to pay the plaintiffs 83⅓% of their claims, or $275,000, and $25,000 for attorney's fees. The assignees for one of these claims, — who had bought it from one of the banks undergoing liquidation as a speculation, — refused to pay the attorneys for the plaintiff the proportionate fee. A referee was appointed. The information he gathered forms the authority for the statements made here. A brief statement of answer of defendant in XXIX *Cordage Trade Journal*, 100.

[2] Detailed account in *New York Commercial*, June 19, 1901, also 72 *Chron.* 1241, June 22, 1901.

[3] Syndicate agreement of May 1, 1901. Also summarized in 72 *Chron.* 1038, May 25, 1901.

On June 4, 1901, the United States Cotton Duck Corporation was incorporated under New Jersey laws. The capitalization was $50,000,000, divided equally into 6% cumulative preferred stock and common stock. It was the purpose of the management to acquire the bonds and stock of the old Mount Vernon-Woodberry Company, and to operate all the mills under one organization. The plan was excellently conceived. With the exception of the liberal issue of common stock, it was conservative. The only objection, from the point of view of fairness, was to the large proportion of stock allotted to the income bondholders, as compared with the first mortgage bondholders.[1] However, had the plan succeeded it would have extinguished the two classes of bonds, and put an end, once for all, to the confusion of corporations and securities, the hopeless tangle of values and responsibilities, which followed the history of the combination. But the plan failed in the most essential part, the elimination of the two classes of bonds. The members of the bond syndicate were given the privilege of withholding their bonds, and not exchanging them into new preferred stock. So many members refused to make the exchange[2] that it was decided to forego that

[1] This point called for condemnation in a number of directions, but since both classes of bonds were pooled by the same syndicate, it is difficult to see an advantage to any party in any apparent partiality. An advantage to the Continental Trust Company was alleged by the plaintiff in the Merchant Trust Company suits on the ground that $1,000,000 of the $6,000,000 were held in the interest of the Continental Trust Company. This was denied by the Continental Trust Company in its answer.

The exchange ratio of the income bonds was 83⅓ % of that allowed the first mortgage bonds. There were no market quotations. The first market quotation was June, 1902, — first mortgage bonds $820 and income bonds $470 per $1,000 bond. Ratio 57 %. The average price of the first mortgage bonds during 1902, 1903, and 1904 was $710 and that of the income bonds $256 per $1,000 bond. Ratio, 36 %.

[2] A committee of the income bondholders later stated that, "The holders of a majority of the securities, stock and bonds of the Woodberry Company were unwilling to make such exchange or accede to such a plan, believing that the valuation proposed to be placed upon the new properties, consisting of the three mills aforesaid, was excessive and unfair to the security holders of the Woodberry Company." Whitridge *et als. v.* Mount Vernon-Woodberry Cotton Duck Company *et als.* Bill of Complaint, page 7.

It appears from substantial evidence that a large proportion of the first mortgage bonds were still held by the original mill owners who had acquired them at

part of the reorganization and permit the Mount Vernon-Woodberry Company to maintain a separate existence with both the classes of bonds outstanding. Accordingly, on February 8, 1902, the stockholders consented to a reduction of the United States Cotton Duck Corporation's capitalization to $30,000,000, half preferred and half common stock. There had been issued in acquiring the new mills $2,750,000 of the $3,100,000 of the preferred stock, and it was proposed to issue to the holders of the Mount Vernon-Woodberry Company's common stock, to the syndicate, and to certain other parties approximately $10,000,000 of the common stock. These amounts remained the issued capitalization of the Company. The details of the reorganization are clear from the table on the following page. As finally accomplished, both issues of bonds remained undisturbed, and the consolidated company had besides assumed $165,000 in annual contingent charges on behalf of its new properties.

One result of the reorganization was the entrance of new influences into the directorate, and the establishment of a more extensive system of distributing the product. Before this, there was only one New England man in the management, but at this time, both William H. Wellington, and Horace S. Sears of Wellington, Sears & Company became members of the Board of Directors, and the former a Vice-President. A few months later, November, 1901, Trenor L. Park, senior member of the large commission house of Catlin and Company, became President, Richard Cromwell having withdrawn. It was believed that a man "from the outside," with a large business experience, would be in a position to manage the administration of the corporation with the least internal friction, and to the advantage of all interests.[1]

the time the Mount Vernon-Woodberry Company was formed. As they still retained the active management of the mills it was impossible for the financial management to carry through a policy to which they were opposed. They opposed any move which appeared to jeopardize the interests of the first mortgage bond holders.

[1] There was much dissension among the old mill owners, who dominated the Board of Directors. Cromwell was severely criticised, especially for his administration of the purchases of raw cotton.

	Old Securities[1]					Anticipated Reorganization Unsuccessful			Accomplished Reorganization						
									Securities Undisturbed			Preferred Stock	Contingent Charges	Common Stock	
	Bonds	Fixed Charges	Income Bonds	Contingent Charges	Stock	Preferred Stock	Contingent Charges	Common Stock	Bonds	Fixed Charges	Income Bonds			Single	Aggregate
Mount Vernon-Woodberry Co.:															
First Mortgage 5% Bonds ($8,000,000 authorized)	$ 7,000,000	$ 350,000	$.	$.	$	$ 7,000,000	$ 420,000	$ ...	$ 7,000,000	$ 350,000	$	$	$		$
Income Bonds	....	....	6,000,000	300,000	.	5,000,000	300,000		....	. .	6,000,000	. .	300,000		
Stock	....	....	. ..	...	9,500,000	. .	..	6,333,333	....	....	....	. ..	....	66⅔%	6,333,333
Synd. for furnishing $2,945,000[2]	.. .	....	....	....	.	3,100,000	186,000	1,550,000	....	....	...	2,750,000	165,000	50%	1,550,000
Stark Mills	....	...	.. .	....	1,250,000										
La Grange & Hogansville Mills	....	....	....	....	750,000[3]										
Issued to various parties	....	.	....	. ..	....	. ..	...	2,116,667	.. .	. .	..	....	....	. .	2,116,667
Total Issued	7,000,000	350,000	6,000,000	300,000	11,500,000	15,100,000	906,000	10,000,000	7,000,000	350,000	6,000,000	2,750,000	465,000	....	10,000,000
In exchange Treasury Bonds of the Mount Vernon Company	. .	..	....	. .	.. .	1,000,000									
Treasury to acquire West Point Group and other properties	....	.. .	....	....	....	8,900,000	....	15,000,000	....	....	....	11,000,000	....	...	5,000,000
Unissued to the Syndicate	....	. .	.	. ..			....	.	....	. .	....	350,000	....	...	....
Total Authorized	....	.. .	....	....	....	25,000,000	. ..	25,000,000	..	.. .	..	15,000,000	.. .	....	15,000,000

SUMMARY	Old	New	Change Amount	Change Percentage New to Old	New	Change Amount	Change Percentage New to Old
Securities bearing Interest	$7,000,000	. ..	$7,000,000	....	$7,000,000	....	100%
Securities bearing Interest and Contingent Charges	13,000,000	$15,100,000	+ 2,100,000	116%	15,750,000	+$2,750,000	121%
Total Securities	24,500,000	25,100,000	+ 600,000	102%	25,750,000	+ 1,250,000	105%
Fixed Charges	350,000	....	− 350,000		350,000	..	100%
Fixed and Contingent Charges	650,000	906,000	+ 256,000	139%	815,000	+ 165,000	125%

[1] Small issues of underlying bonds on the Tallassee Falls and Hogansville Mills omitted from consideration as not affected by the reorganization.
[2] For probable distribution of money (see note, page 349).
[3] The stock of the mills being in private hands has been entered at approximately the price at which it was acquired.

The United States Cotton Duck Corporation, however, was not prosperous. Conceived in 1901, when the textile business in general underwent a severe relapse from the marked activity of 1899 and 1900, the new corporation had to bear the burden of increased charges when conditions in the industry were unsettled. The disastrous results of the first half year of 1901, while the reorganization was being discussed, have been already described. Fortunately the business for the last half of the year gave a better result, so that for the year as a whole, there was some manufacturing profit. Yet after payment of the interest on the Mount Vernon-Woodberry Company's first mortgage bonds, the Company's books showed a net deficit of over $350,000.[1] As a result of these unfortunate conditions, the Board of Directors decided not to pay the interest on the income bonds of the Mount Vernon-Woodberry Company, "because of the magnitude of the Company's business and the number of items which might suffer a depreciation equal to the profits as shown by the statement."[2] During the first half year of the United States Cotton Duck Corporation's existence, June to December, 1901, its own mills, acquired at an expenditure of $2,750,000 of preferred stock, and over $1,500,000 of common stock, showed earnings of $106,444,[3] or slightly in excess of the amount required for the preferred stock dividend. In reference to the unsatisfactory results of the year, the management stated, "The last year (1901) was perhaps the most unsatisfactory year the cotton manufacturing concerns have experienced since 1884."[4] Meanwhile, the market price of the United States Cotton Duck Corporation's common stock sank in February, 1902, to $16 a share, exactly one-half what it had been at the time of incorporation, ten months before.

During the calendar year of 1902, the earnings of the two companies were better than those of the preceding year. The earnings for the first six months enabled the Mount Vernon-

[1] For detailed statement of earnings of the Mount Vernon-Woodberry Company, see page 377.

[2] 74 *Chron.* 385, February 15, 1902.

[3] *Ibid.*

[4] *Ibid.*

Woodberry Company to resume the payment of the interest on its income bonds, and to carry a small amount to surplus.[1] The United States Cotton Duck Corporation paid, too, a dividend of 3% on its preferred stock. Nothing, however, was charged to depreciation, although a few months later several mills were closed down, and subsequently abandoned, because their operation involved extensive repairs.[2] During the second six months of 1902, the companies were less successful than in the previous half year,[3] and the Directors passed the semi-annual interest on the income bonds of the Mount Vernon-Woodberry Company again.[4] This precipitated a further decline in market prices of the securities, and more or less open attacks on the management. At this juncture, the President retired,[5] and Charles K. Oliver assumed the position. The latter gave out for quotation, "I propose to manage the affairs of the corporation without reference to what may be the general market condition regarding the securities of the corporation."[6] But the earnings of the Company were not resuscitated and by the middle of 1903, the income bonds of the Mount Vernon-Woodberry Company had a nominal market price of 14½%,—$145 for a $1,000 bond,—and the common stock of the United States Cotton Duck Corporation was nominally bid for at $1 a share.[7] It was now quite clear to all concerned with the Company's business, that the cotton duck consolidation was not a successful enterprise.[8]

[1] 75 *Chron.* 247, August 2, 1902.

[2] Beginning with closure of the old Greenwoods (J. Spencer Turner) Mill at New Hartford, Conn., on September 1, 1902. 75 *Chron.* 294.

[3] For detailed statement of earnings, see p. 377.

At the time of the United States Cotton Duck syndicate an option was obtained on the stock of the West Point Manufacturing Company. Owing to lack of money this option was not exercised and the West Point mills became competitive.

[4] 76 *Chron.* 439.

[5] 76 *Chron.* 216. The President's retirement was said to come "because of the pressure of other duties."

[6] 76 *Chron.* 434.

[7] During the latter part of 1903, nominal quotation, bid $1 a share, asked $2 a share.

[8] Stated, for example, in contemporary comment, — "The management of the Mount Vernon-Woodberry Cotton Duck Company for some reasons, not disclosed, has not been successful." Hambleton & Company, market letter, July 11, 1903.

The first reorganization, conceived to extend the control of the Company and to simplify its financial structure, had been successful in the former purpose, but greater control did not inhibit competition, nor maintain prices on an evenly remunerative basis. On the contrary, the formation of the United States Cotton Duck Corporation served, apparently, to stimulate competition along new lines, and to render even more complicated the already complex financial organization of the consolidation. Instead of expansion, the remedy must lie in contraction; instead of the expenditure of more money in acquiring competitive interests, new working capital must be furnished in order to facilitate the conduct of the present business; instead of the variety of securities, necessitated by the legal separation of one company from the other, greater unity must be secured. These were the reflections of a number of men interested in the welfare of the consolidation. To accomplish them, four distinct plans of reorganization were successively tried. The first plan was a failure, because of the unwillingness of the stockholders to suffer an assessment. The other three led to three separate reorganizations, — that of 1905, of 1910 and 1913. It is the purpose of the present chapter to discuss the circumstances leading up to and following the reorganization of 1905. The last two reorganizations, being perhaps the most complex in industrial financial history, will be reserved for the succeeding chapter.

Early in the spring of 1903, at the time the Directors passed the interest on the income bonds, the report was circulated that some effort would be made to simplify the finances of the two companies. Early in May, 1903, it was definitely stated that the Directors contemplated merging them and retiring the income bonds of the Mount Vernon Company by a new and smaller issue which should cover the entire property of the consolidation.[1] In furtherance of this purpose, a Committee was selected, of which S. Davies Warfield was Chairman [2] to "pro-

[1] See reference to forthcoming plan of reorganization in 76 *Chron.* 977, May 2, 1903.

[2] This committee was called the "Readjustment Managers." Besides Mr. Warfield, there were Messrs. J. W. Middendorf, a banker who had had financial

pose and issue plans looking to a more complete merger of the interests of the United States Corporation with the Mount Vernon-Woodberry Company on terms fair to both, and to provide additional working capital for the combined companies."[1] Members of the Committee informally suggested that this might be accomplished by the retirement of the two issues of old bonds and the preferred stock, and the issuance of new bonds and stocks covering the entire assets of the two companies. As much turned upon the treatment of the income bonds of the Mount Vernon-Woodberry Company, then quoted at approximately 18%, — \$180 for a \$1,000 bond, — a protective committee of five Baltimore bankers was selected by some of the large holders.[2]

Early in June, 1903, the first plan of reorganization was announced. It contemplated the formation of a new corporation with \$7,500,000 of first preferred stock, \$12,500,000 of second preferred and \$10,000,000 of common stock.[3] This plan was only tentative, however. By the last of the month the final plan was announced. From the preamble of the circular sent out by the Readjustment Managers, it is clear that the men had most conspicuously in mind the improvement in the market value of the securities of the two companies. Four features considered essential to a successful plan were briefly defined. Two of these referred to an enhancement in the market of the securities, and the other two involved the formation of a new company, and the increase in its working capital.[4] As the plan was not consummated, its details need detain us but a moment.

experience in the affairs of the Seaboard Air Line, Gustavus Ober and H. A. Orrick, brokers, and Thos. M. Turner, one of the selling agents. These gentlemen, like most who guided the affairs of the duck consolidation, knew, with the exception of Mr. Turner, nothing about the duck business. Their interest was in the market for its securities.

[1] 76 *Chron.* 1089.

[2] J. Wilcox Brown (Pres., Maryland Trust Company), J. H. Ferguson (Pres., Colonial Trust Company), Douglas H. Gordon (Pres., International Trust Company), Jesse Hills (coal dealer), and Douglas H. Thomas (Pres., Merchants National Bank).

[3] Brief summary in 76 *Chron.* 1253, June 6, 1903.

[4] Readjustment plan (June, 1903), page 1, lines 13 f.

The Mount Vernon-Woodberry Company was to be merged with the United States Cotton Duck Corporation, which was to issue a blanket mortgage for $14,000,000 of which $8,000,000 of bonds was to be reserved in order to retire the Mount Vernon-Woodberry Company's First Mortgage bonds. The income bondholders were required to buy these bonds to the extent of 25% of their holdings, in consideration of which they were to secure 5% new cumulative preferred stock to the full extent of their holdings. The holders of United States Cotton Duck Corporation's preferred stock were allowed the new bonds to the par value of their stock, and the holders of the common stock were allowed new 6% non-cumulative second preferred stock to the extent of 60% of their holdings, and 40% in common stock, provided they bought new bonds to the extent of 5% of their stock. The proposed distribution can be most readily interpreted from the table given on the next page. It left the total amount of securities about the same, but involved the investment of new capital to the extent of $2,000,000. It was far from conservative at best. On the second page of the Readjustment Managers' circular, all the mills are stated to be worth $17,000,000. As the Mount Vernon-Woodberry group was valued in this estimate at $14,250,000, the larger figure is obviously excessive. Taking it, however, as a basis, and adding the $2,000,000 in money, we may conclude that the Directors valued the property back of the securities of the new company at $19,000,000. Against this they proposed to issue over $29,-000,000 of securities carrying fixed charges of $583,000 and total charges of over $1,100,000 a year. The gross manufacturing profit of the preceding year had amounted to a little over $1,000,000, and this estimate was subsequently scaled down by independent auditors to $970,000.[1] But out of this amount, $217,000 was paid in interest on the floating debt, $79,000 for repairs, and other legitimate charges to earnings reduced the total amount available for interest charges to only $515,417. Subsequent disclosures indicated that there had been inadequate charges to depreciation.

[1] Audit Company of N. Y., $970,337.84.

Corporations	OLD COMPANIES: Bonds	Fixed Charges	Income Bonds	Preferred Stock	Con-tingent Charges	Common Stock	NEW COMPANY: Assessment		First Mortgage Bonds		Fixed Charges	First Pref. Stock (5% Cumulative)		Second Pref. Stock (6% Non-Cumulative)		Con-tingent Charges	Common Stock	
							Single	Aggre-gate	Single	Aggre-gate		Single	Aggre-gate	Single	Aggre-gate		Single	Aggre-gate
	$	$	$	$	$	$	%	$	%	$	$	%	$	%	$	$	%	$
Underlying Bonds	425,000	26,750	....	....	...	...		...	100	425,000	26,750							
Mt. Vernon-Woodberry Cotton Duck Co.:																		
First Mortgage Bonds (Treasury $1,000,000) .	7,000,000	350,000	...	....	....	....	..	....	100	7,000,000	350,000							
Income Bonds	....	...	6,000,000	...	300,000	....	25	1,500,000	25	1,500,000	75,000	100	6,000,000	..	....	300,000		
United States Cotton Duck Co.:																		
Preferred Stock	....	....	..	2,750,000	165,000	....	..	...	100	2,750,000	137,500							
Common Stock	....	....	..	...	..	10,000,000	5	500,000	..	....	...	..	....	60	6,000,000	360,000	40	4,000,000
Total Issued	7,425,000	376,750	6,000,000	2,750,000	465,000	10,000,000	..	2,000,000	.	11,675,000	589,250	..	6,000,000	.	6,000,000	660,000	..	4,000,000

SUMMARY	Old	New	Change: Amount	Percentage New to Old
Securities bearing Interest Charges	$7,425,000	$11,675,000	+$4,250,000	157%
Securities bearing Interest and Contingent Charges	16,175,000	23,675,000	+ 7,500,000	146%
Total Securities	26,175,000	27,675,000	+ 1,500,000	105%
Fixed Charges	376,750	589,250	+ 212,500	157%
Fixed and Contingent Charges	841,750	1,249,750	+ 407,500	149%

Immediately after the plan was announced, a strong opposition arose among the income bondholders.[1] This was backed by the sentiment among Baltimore bankers, who generally regarded the plan as a means of strengthening the security of the Mount Vernon-Woodberry first mortgage bonds, by compelling the holders of the junior liens to furnish new working capital. The income bondholders themselves demanded to know how the new money was to be employed and suggested, at the same time, that what the Company most needed was an entire change of management.[2] Independent auditors were selected to go over the books of the two companies, and their report was not as favorable as the statements of the company. Confronted with adverse criticism, the Readjustment Managers withdrew their plan, and announced in the press advertisements that "this time is not deemed advisable to make operative any plan which contemplates an assessment on the security holders."[3]

During the years 1903 and 1904, there were few significant changes in the affairs of the two cotton duck companies. Practically no charges were made to depreciation, although the policy was not so suicidal as might be supposed, on account of the heavy structure of the cotton duck machinery. During that time, the earnings steadily decreased,[4] and the first mortgage bonds of the Mount Vernon-Woodberry Company, the premier security of the whole consolidation, reached a low record of 59% in the middle of 1904. The common stock of the United States Cotton Duck Corporation continued to have a nominal quotation of $1 a share. Throughout this period, until 1905, absolutely nothing was charged to depreciation.[5]

[1] Expressed by the income bondholders' committee especially referred to in notes on page 357.

[2] A good summary of the prevailing sentiment is found in Hambleton & Co., market letters of July, 1903. Comments in the local Baltimore newspapers show the dissatisfaction.

[3] 77 *Chron.* 1750, November 7, 1903.

[4] See details of earnings, p. 377.

[5] The absence of depreciation charges directly stated by the Mount Vernon management. Whitridge *v.* Mount Vernon Company. Answer of the Mount Vernon Company, page 36. See further page 372, note 1.

Early in 1905, the hope for a successful plan of adjustment was again advanced. Other men had meanwhile entered the management[1] and all interests concerned coöperated in a committee formed to devise plans for the rehabilitation of the consolidation.[2] On May 8, 1905, this Committee announced its plan of reorganization with the comment: "We are convinced that satisfactory results can only be obtained if the securities be readjusted to a more conservative basis." This plan, formulated with the consent of representatives of all interests, was immediately successful.

The Consolidated Cotton Duck Company was incorporated under the laws of Delaware, with a capital of $6,000,000 of 6% cumulative preferred stock, and $7,000,000 common stock. The Mount Vernon-Woodberry Company's first mortgage bonds were allowed to remain undisturbed. All other securities, except the stock of the Mount Vernon-Woodberry Company, which was practically[3] all owned by the United States Company, were exchanged for the new stocks of the Consolidated Cotton Duck Company. The crux of the reorganization was the exchange of the old income bonds into new preferred stock, and the fact that over 90% of the holders of the income bonds consented to such a change determined the success of the plan of reorganization. At the same time, the stockholders in the old United States Cotton Duck Corporation consented to take the securities of the new corporation, so that the United States Company passed out of existence as a separate corporation. Henceforth there remained only the underlying first mortgage bonds of the Mount Vernon-Woodberry Company, and the preferred and common stocks of the Consolidated Cotton Duck Company. The latter existed as a holding company for

[1] Annual meeting, February 18, 1905. W. A. Marburg (tobacco), W. H. Grafflin (fertilizers), C. K. Lord (coal), E. L. Bartlett (iron tanks).

[2] The committee consisted of S. Davies Warfield, Chairman —

Douglas H. Thomas	G. C. Goodrich	Edward H. Thomson
Geo. K. McGaw	S. S. McKim	Elbert A. Brinckerhoff
John E. Borne	Harry A. Orrick	Arthur Lehman

[3] 90,318 shares out of 95,000. Plan and agreement of May 8, 1905, p. 2. The holdings by the Consolidated had increased to 94,868 shares December 31, 1910. 1910, International Cotton Mills Corp. Rep. 14.

	OLD COMPANIES						CONSOLIDATED COTTON DUCK COMPANY						
	Bonds	Fixed Charges	Income Bonds	Preferred Stock	Contingent Charges	Common Stock	Bonds	Fixed Charges	Preferred Stock Single	Preferred Stock Aggregate	Contingent Charges	Common Stock Single	Common Stock Aggregate
									%			%	
Mt. Vernon-Woodberry Co.:													
Underlying Bonds ...	$250,000	$15,000	....	...	....	...	$250,000	$15,000					
First Mortgage Bonds[1]	8,000,000	400,000	...	....	....	...	8,000,000	400,000					
Income Bonds	....	....	$6,000,000	....	$300,000	...	....	....	50	$3,000,000	$180,000	$16\frac{2}{3}$	$1,000,000
United States Cotton Duck Corporation:													
Underlying Bonds ...	175,000	11,750	....	....	....	....	175,000	11,750					
Preferred Stock	....	....	...	2,750,000	165,000	....	....	....	100	2,750,000	165,000	$72\frac{8}{11}$[2]	2,000,000
Common Stock	....	....	...	...	....	$10,000,000	...	....	...	....	....	40	4,000,000
Total Issued	$8,425,000	$426,750	$6,000,000	$2,750,000	$465,000	$10,000,000	$8,425,000	$426,750	..	$5,750,000	$345,000	....	$7,000,000
Treasury	....	....	....	....	....	.....	....	...	...	250,000			
										$6,000,000			

SUMMARY	Old	New	Change Amount	Change Percentage New to Old
Securities bearing Interest	$8,425,000	$8,425,000		100%
Securities bearing Interest and Contingent Charges	17,175,000	14,175,000	−$3,000,000	83%
Total Securities	27,175,000	21,175,000	− 6,000,000	80%
Fixed Charges	426,750	426,750		100%
Fixed and Contingent Charges	891,750	771,750	− 120,750	88%

[1] The $1,000,000 of bonds previously held in Treasury had been used as collateral for loans.

[2] $200 of new for each $275 of the old.

the Mount Vernon-Woodberry stock, and an operating company for the mills of the old United States Cotton Duck Corporation. The distribution of securities in the reorganization may be seen from the table given on the previous page.[1]

The reorganization brought about no improvement in the underlying bonds or the fixed charges. In attempting the previous unsuccessful reorganization, the management had found it impossible to induce the holders of the first mortgage bonds of the Mount Vernon-Woodberry Company to refund their lien into stock, and no similar attempt was made at this time. The permanence of the large debt was, obviously, the weakest point in the entire reorganization. As a whole it accomplished little, except the extinction of the income bonds with their anomalous standing. They had been a financial blunder in the first place. Since their issue, they had proved a constant source of annoyance, both to the corporation[2] and the investing public, for through their nominal lien on the fluid assets of the cotton company, they had greatly disturbed its facilities for obtaining bank credits. The reorganization was expensive, and was accomplished only with the settlement of the old United States Cotton Duck syndicate litigation, at a direct expense of $310,000. The interest charges remained the same, although the entire volume of securities was somewhat

[1] Details taken from Plan and Agreement for the acquisition by the Consolidated Cotton Duck Company of securities of the Mount Vernon-Woodberry Cotton Duck Company and the United States Cotton Duck Corporation. Dated May 8, 1905.

[2] Owing to the fact that the income bonds made no provisions for allowing depreciation out of net earnings, — a blunder which was inexcusable on the part of the men who passed on the wording of the income bonds, — the Company was continuously harassed by the divergence between its own welfare and the demands of the income bondholders. For example the Mount Vernon Company admitted that it paid for its additions and betterments " not out of its net revenues, but from its original, so called quick assets, or working capital." (Whitridge *v.* Mount Vernon-Woodberry Company. Answer of Mount Vernon-Woodberry Company page 24.)

As a matter of fact there was a difference in the wording between the bonds and the mortgage. The latter included among the reservations to be deducted before computing net earnings " charges for depreciation by age or wear "; these words were omitted in the statement on the face of the bonds.

lessened. No new money was added. The intricate relationship between an operating and a holding company was not eliminated, as the Consolidated Company assumed a position corresponding exactly to that of the old United States Company. With the exception, therefore, of the practical extinction of the income bonds, the financial position of the Cotton Duck consolidation was worse than before the readjustment.

From the point of view of the various security holders, the terms of the reorganization were eminently fair. The income bondholders surrendered whatever value lay in their second mortgage lien on the Mount Vernon-Woodberry mills, but obtained a direct interest in the valuable Stark Mills, and the other assets of the United States Company. On the other hand, the stockholders of the United States Company, which owned practically all the stock of the Mount Vernon-Woodberry Company, were benefited by the improvement in the financial position of the latter company. These facts were fully recognized by all interests, and by June 1, 1905, hardly three weeks after the plan was announced, "upwards of three-fourths of each class of securities having assented to the plan"[1] the Committee declared the reorganization operative. By June 8, about 85% of all classes[2] of securities had been deposited, and the permanent organization of the Company was effected shortly.

Unfortunately, the new men brought into the Consolidated Company were as unfamiliar with cotton duck manufacturing as their predecessors.[3] As a whole, however, the closer organization of the new Company was a move toward greater efficiency, and the earnings for the first six months showed a marked

[1] Newspaper advertisement. Reproduced in 80 *Chron.* 2346, June 3, 1905.

[2] Income bonds $5,218,000 out of $6,000,000 — 87 %.
Pfr. Stock United States Co., 22,481, out of 27,500 shs. — 82 %.
Com. Stock United States Co., 89,050 out of 98,000 shs. — 91 %.
80 *Chron.* 2460, June 17, 1905.

[3] The new men entering on the executive committee of six were George K. McGaw, a retail grocer, F. S. Landstreet, and J. H. Wheelwright, President and Vice-President of the Consolidation Coal Company, respectively. The men on the Board of Directors who were familiar with the cotton business were familiar with the sale rather than the manufacture of duck.

improvement over those of years preceding,[1] and in furtherance of the policy of reorganization, the management sought the advice of technical engineers, with a view of improving the efficiency of the mills. They recommended the expenditure of $1,000,000 for improvements, and especially for new machinery.[2] The management planned to authorize the improvements suggested, but the policy was discontinued subsequently on account of the difficulty in obtaining the necessary money.

Soon after the consummation of the reorganization, and partly as a result of the closer organization, the new management began to consider the desirability of concentrating the sale of its goods in a single agency. Its contracts with the old selling houses, J. Spencer Turner and Wellington, Sears and Company expired December 31, 1905. The lack of correlation and the necessary overlapping resulting from the use of four selling agencies for the Company's product had become clearly apparent.[3] Some of the Directors advocated the establishment of an independent system of agencies similar to the system adopted by the New England Cotton Yarn Company.[4] The management were

[1] Net, for half year ending December 31, 1905, applicable to dividends after payment of all fixed charges, $328,451. See page 377, for details of earnings of the Consolidated Cotton Duck Company.

[2] Notice of this appeared in the *Commercial and Financial Chronicle* as follows, — "A committee of expert mill engineers, having inspected the plants of the Mt. Vernon-Woodberry Cotton Duck Co., recently recommended the expenditure of $1,000,000 for improvements. It is accordingly proposed to make improvements from now on as necessary." 81 *Chron.* 314, July 15, 1905.

[3] "After trying other methods of handling its sales, the defendant adopted the plan of selling through the agency of several different companies to each of whom it paid a commission of three and one-half per cent upon sales made, the agents paying all expenses of selling the goods and guaranteeing the collections; and agreeing further to make advances in money to defendant upon goods consigned; and in order to prevent competition among such agents, defendant divided, or attempted to divide, its business not upon territorial limits but upon the basis of the different classes of goods manufactured by it, giving each agent an exclusive right to sell certain specified products. And defendant shows that with the best of intentions on every side there naturally arose controversies among the sales agents and between such agents and defendant." Whitridge *v.* Mount Vernon Cotton Duck Company. Answer of defendant, Mount Vernon-Woodberry Cotton Duck Company, page 26.

[4] The feeling was expressed that the selling commissions were too high. They were about 3.5 %. This included not only the actual sale of the goods but also the

deterred from a serious consideration of this purpose by negotiations looking to the outright purchase of the J. Spencer Turner Company.[1] It was finally acquired by the Consolidated Cotton Duck Company, and reincorporated as a New York Corporation with a capital stock of $500,000 and an issue amounting to $2,000,000 of 6% debenture bonds due in 1926. The entire issue of stock passed directly into the treasury of the Consolidated Duck Company. Of the debenture bonds, approximately $900,000 and some money went directly to the stockholders of the old Turner Company in consideration for their interest. Of the remaining $1,100,000 in debenture bonds, $700,000 were taken by a syndicate, managed by the Continental Trust Company, subject to a right of the shareholders to purchase them at 95%. The remainder of the issue, $400,000, was deposited in the treasury for future needs.[2] In return for the entire stock of the Turner Company, the Consolidated Company guaranteed the principal and interest on the debenture bonds. Reduced to its simplest form, this bit of financing represented an increase in the funded liabilities of the Consolidated Company of upwards of $1,500,000, and in fixed charges of $90,000 a year, together with a sinking fund of $75,000 beginning January 1, 1908, in return for the "good-will" and possible earnings of their chief selling agent.[3] It was said at the time the selling company was

guarantee of the accounts. Judged by the commissions usually paid the percentage was not excessive, yet in view of the meagre profits the Company was making, it appeared large to the stockholders.

The J. Spencer Turner Company received 5% on its London sales and $7,000 a year for incidental expenses. A similar arrangement was continued after the Turner Company had been acquired. (Whitridge *v.* Mount Vernon Company. Answer of Mount Vernon Company.)

[1] The J. Spencer Turner Company was originally established in 1810, as Brinckerhoff and Greenough, later Fox and Polhemus; Theodore Polhemus & Co.; Brinckerhoff, Turner & Polhemus; Brinckerhoff, Turner & Co.; incorporated 1897 as J. Spencer Turner Company with a capital stock of $750,000.

The J. Spencer Turner Company, it will be remembered, sold the Greenwoods Mills to the original Mount Vernon-Woodberry Company at an excessive figure, and the Company had since been closely identified with the cotton duck consolidation as its chief selling agent. See page 338, note 5.

[2] 82 *Chron.* 1103, May 12, 1906.

[3] The J. Spencer Turner Company, besides selling the product of the Consolidated Company's mills, also distributed the product of two Canadian mills, —

purchased that these earnings "will approximate over $300,000."[1] They never averaged $300,000 and in a number of years fell below $200,000.[2] Considering that the assets of the Turner Company, aside from the equities in certain Canadian mills of slight earning power,[3] consisted very largely in the reputation of the Consolidated Company's own trade-marks and brands, one is led to question the wisdom of thus increasing the capital liabilities and fixed charges at what proved to be a critical time in the Company's history.[4] Moreover, the move stimulated competition, as the other selling agents, being cut off of their supplies of coarse fabrics, established duck mills of their own. This was a result similar to that which followed the establishment of the New England Cotton Yarn Company's policy of distributing its own goods.

Nor was this the only source of competition. Speaking to the stockholders of the condition of the Consolidated Cotton Duck Company, up to and through 1905, the Chairman of the Board of Directors said, " During this time you have seen some of those who have sold their properties to your Company leave and build mills to compete with the Company to which they sold out." [5] During the first years of the existence of the Mount Vernon and United States Companies, the proportion of duck produced by their mills was so great that the consolidation was able to control prices within reasonable limits. In order

in which it owned a controlling interest, — and the Washington Mill and a mill in Cincinnati.

[1] 82 *Chron.* 1103, May 12, 1906.

[2] Net earnings before deductions for interest and sinking fund. If allowances for liquidated accounts are subtracted, as they should be, the net earnings before charges have been very much less than $300,000 a year.

[3] Cosmos Mills, Yarmouth, Nova Scotia; Imperial Mills, Hamilton, Ontario.

[4] This same view was taken by Judge Rose " In view of the chronic need for ready money of both the Mount Vernon and the Consolidated, it is not quite so easy to understand why this large investment should have been made in the selling agent's business." Whitridge *v.* Mount Vernon. Opinion of Rose, D. J. (*Baltimore Daily Record*, January 14, 1914.)

[5] Digest of entire report to stockholders in 82 *Chron.* 626, February 24, 1906.

This competition was very harassing. For example one of the Hoopers started a mill, using for the name of his company his own name, — William E. Hooper, — which happened to be the old name of the Company operating the old Woodberry mills.

to pay their fixed charges and show any surplus at all, it was necessary for them to maintain prices at a high level. This policy, successful perhaps at first because of the unprecedented demand for their goods, proved short-sighted and self-destructive. Mills all through Maryland, and to a less extent elsewhere, were refitted as duck mills. New capital was attracted into the industry by the relatively wide margin of profit, and the new mills, being equipped with more modern machinery, were able to manufacture duck at a lower net cost than the Consolidated Company. For this reason, the competitors were, as a general rule, on very friendly terms with the larger company. They recognized clearly that it was the price policy of the company which produced over half the duck fabrics of the country that enabled them to dispose of their own products with a liberal margin of profit.

The earnings of the Consolidated Company for 1906 showed a substantial increase over those of the preceding year. It was a year of marked activity in every industry, and Chairman Warfield, commenting on it at a later time, wrote to the stockholders, "The year 1906 was a banner year for the earnings of these properties."[1] Yet the market values of the various forms of securities were not favorably affected, and the Chairman of the Board of Directors issued a report in which various statements were made for the purpose of inspiring confidence in the Company.[2] The total net earnings of the Company after meeting

[1] Report for fiscal year ending December 31, 1907. Pamphlet to stockholders, digest, 86 *Chron.* 917.

[2] Unfortunately, the entire pamphlet cannot be reprinted. Some of the statements, however, afford interesting comment at this point in the narrative.

The report began by noting the advantages gained by the reorganization. "If at the time of my last report you may have felt that sufficient time had not elapsed to demonstrate the wisdom of the plan for the merging of the two cotton duck corporations into the Consolidated Cotton Duck Company, the annual statement of your President for the fiscal year 1906 must remove any doubt if such existed. Your President's statement for the twelve months ended December 31, 1906 shows income of over $10,000,000, and net earnings of $908,914.73, after taking care of fixed charges on all the underlying securities of both of the former constituent companies" (page 4).

The Chairman of the Board shows concern over the market value of the Company's securities. "When you consider the actual value of the mill, and other

all the fixed charges were $908,915, without considering the profits of the Turner Company. It was distinctly the most prosperous and promising year for the consolidation since

properties which have come into possession of the Consolidated Cotton Duck Company as certified to by Messrs. Barrow, Wade, and Guthrie, Chartered Accountants, when these properties were originally purchased and without figuring therein any increased value from earnings during this period, when you consider that the actual cash derived from the sale of the securities of the two Cotton Duck corporations (which now constitute your company, which securities are now represented by the bonds of the constituent companies and the preferred and common stock of the Consolidated Cotton Duck Company) and compare these figures with the present Baltimore market value of these securities, you will find ample reason for my insistence that the stockholders of this Company give closer study to their property that they may understand and appreciate its real worth. By consulting table ' D ' you will note that the actual valuation of the properties is approximately $18,000,000. Yet by reference to table ' E ' the present market value of all the securities of both the constituent companies and the Consolidated Cotton Duck Company aggregates only $12,750,000, a difference of $5,250,000 between actual value and present market values, or an excess in actual value of over forty per cent. But what is more striking is the difference between the market value of these securities and the actual cash that was paid for the securities which the present securities now represent. There was derived from the sale of the securities of the two companies constituting the Consolidated Cotton Duck Company $15,270,000 in cash. The market value of your securities therefore is $2,520,000 less than the cash so raised. No reason for this can be found in the earnings of your properties as you have already seen from your President's report. . . . You have no bonus stock in this company" (page 7).

The Chairman of the Board manifests a local pride in the Company's success. "Your company is one of the largest industrial enterprises in this state and is the only large Baltimore-controlled industrial enterprise of international scope. Speaking for myself alone, and by reason of my long association with the development of this enterprise from its start, I should feel extremely sorry if our own people are lacking in appreciation of the position which it commands for us, and our city in the industrial world; and now that its soundness has been so fully demonstrated it is to be hoped that our own people will save to this city the emoluments which must come from the continued ownership and operation of so large and successful an enterprise in the field of manufacture which has so long been pointed out, it is so essential for Baltimore's best interests to develop" (page 8).

Report of S. Davies Warfield, Chairman of the Board of Directors, submitted at meeting of February 18, 1907. Brief and unsatisfactory digest in 84 *Chron.* 801.

Mr. Sheldon, an engineer of Providence, made an "off-hand" judgment that the mills were not worth the face of the first mortgage bonds, — $8,000,000. A similar view was taken by the Court. "Its first mortgage securities amount on the most favorable showing to very nearly as much as the debtor's tangible assets are worth." Whitridge *v.* Mount Vernon. Opinion of Judge Rose. (*Baltimore Daily Record*, January 14, 1914.)

the period of abnormal profits following immediately after the inception of the Mount Vernon-Woodberry Company. The large profits of the year 1906 were possibly due, in part at least, to the Russo-Japanese war.[1] At all events, they gave new hope to the management of the Company.

In 1907, the increasing severity of competition affected the earnings of the Consolidated Cotton Duck Company unfavorably, although, apparently, the preferred stock dividend was fully earned. This fall in the manufacturing profit was attributed to the general business depression, which was, too, a very real factor in 1908, when the semi-annual dividend was cut to 2%,[2] in the first half year, and to 1% in the second. Meanwhile, the distance between the reported "actual valuation of the properties," and the "market value of the securities" grew wider. The preferred stock of the Consolidated Cotton Duck Company declined to $20 a share in 1908, and the bid quotation for the common stock was $5 a share.

So far as profits were concerned the calendar year 1909 was the most unfortunate ever experienced by the consolidation since its formation ten years before. The total production had fallen off, and the operations for the entire group of mills, before allowing for the interest in the Mount Vernon-Woodberry Company's bonds, showed a deficit of $80,810. Nothing was charged off to depreciation, and there was, apparently, a charge of only $70,555 to repairs and renewals. After the payment of the interest on the underlying Mount Vernon-Woodberry Company's bonds, the deficit amounted to $506,210. The most discouraging feature of the report was that the whole of this

[1] This supposition was advanced by a man of whose intimate familiarity with the Company, the present writer is doubtful. It seemed plausible, however.

[2] When the preferred stock dividend was first cut, the management made the following statement, — "Conforming to the conservative policy of the management, it was deemed advisable, in view of general industrial depression, and particularly as the stock is cumulative, to withhold the usual 3 % semi-annual dividend making it 2 %. It will be recalled that after the panic of last year the management of the Company determined to curtail the output, and therefore all the mills are put on a manufacturing basis of output equal to about 54 % of the production of last year." — Part of report for half year ending June 30, 1908, 87 *Chron.* 477, August 22, 1908.

deficit had accumulated, according to the reports of the Company, during the second half year, a condition of affairs which presaged little good for the immediate future. This unfortunate condition was attributed by the management to the high price of cotton, and to general trade conditions,[1] the identical causes to which the early management of the New England Cotton Yarn Company attributed its failure in 1903. Prior to this the management had employed Mr. Sheldon, a mill engineer of Providence, to make a "complete and honest" report of the conditions at the mills. He found that the buying of cotton, the administration of the selling, the management of the mills and the condition of the machinery were all very bad. The errors in the buying of cotton, during the year of 1909, had been the chief cause of the calamity of that year. The raw staple had been driven upward in price through successful speculative manipulation from about nine cents a pound to over sixteen cents. During the operation of this corner, — the Patten corner it was called, — the management had failed to cover their sales of duck by purchases of raw cotton, believing that the high price was occasioned by speculation and would be followed shortly by a severe break in the market price. They were wrong, and the heavy manufacturing losses resulted.

Behind the outward evidence of protracted failure, as evidenced by the financial statements of the Company, there lay underlying conditions of extreme seriousness. The costs of production were abnormally high, owing to the fact that the mills had been allowed to run without setting aside proper reserves for depreciation and totally inadequate charges to repairs and renewals. During the best year, all things considered, in the Company's history, which the Chairman of the Board of Directors called "the banner year," only $283,735 was charged to depreciation on mills which were alleged to have an actual net value of $18,000,000. For the ten years from January, 1900 to January, 1910, an average of only $68,260 was charged

[1] "The rapid rise in price and continued high price of cotton, with the attending general conditions surrounding the staple had not been experienced for 23 years." President Thomas M. Turner in Report for fiscal year ending December 31, 1909.

to depreciation,[1] whereas the proper charge should have been at least $250,000.[2] Before 1906, the management admitted that the charge to depreciation was inadequate.[3] Yet during the early years of the consolidation such a policy bore no evil fruit, owing to the large demand for the Company's product, which enabled the management to dispose of the total output of the mills without regard to the cost of production. Furthermore, the machinery for the manufacture of coarse goods, being heavy, has a much longer life than the machinery in a fine goods

[1] The charges to depreciation can be seen from the following table. Prior to 1905 there had been no charges to depreciation, although the management laid great emphasis on its conservatism in charging off, in 1902, the cost of repairing the dam at the Tallassee Falls Mills, — $79,816.

Calendar year	Charge to depreciation
1899–1904	0
1905	$259,041
1906	283,735
1907	96,922
1908	42,908
1909	0
Total charges	$682,606
Average for ten years	68,260

The Mount Vernon Company's management stated explicitly, in the Whitridge income bond litigation, that nothing had been charged to depreciation prior to 1905. The above charge for 1905 is taken from the Mount Vernon Company's answer in the above suit. Other figures from published financial reports.

[2] Testimony in the Whitridge income bond litigation. Reviewed by Rose, D. J., "It is admitted that the average annual depreciation of the buildings, machinery, etc., of the Mount Vernon would amount to $375,000. The sum reserved for depreciation has been $300,000 a year less than was required to maintain the company's property at its original value." (Opinion given in full, *Baltimore Daily Record*, January 14, 1914.) Considering the heavy construction, it would seem to the present writer that depreciation charges of $375,000 were somewhat excessive. It would seem that one dollar a spindle on the 250,000 spindles or $250,000 would be more nearly correct.

[3] In the report of the Chairman of the Board at the meeting of February 18, 1907, — previously referred to, — is the statement: "There is one point to which your especial attention is invited and that is the question of depreciation in the mills of the Mount Vernon-Woodberry Company. With the view of placing the mills of that company in the proper condition, the management has been replacing obsolete machinery, long since out of date, by the advance in textile manufacturing methods, with modern machinery. . . . This depreciation account has been inadequate." The relatively small charges for the three years after this statement was made are indicated in the preceding note.

mill. But during the later years of the consolidation, in the presence of the keen competition of the newer mills, when even the heavy machinery showed clear signs of its age and long use, the margin between the cost of production and the selling price grew narrower and narrower. In the Stark mill, where the finer goods were made, the results of the policy of under maintenance were even worse than in the southern mills. The condition of the Consolidated Cotton Duck Company at the end of 1909 was very clearly expressed by Myron C. Taylor in a circular letter about a year later. After stating the necessity of " adequate working capital, and efficient operating management, both of which were at that time a pressing need," he states, " There had arisen a situation in the affairs of the Consolidated Cotton Duck Company, when it did not feel justified in longer continuing to supply adequate working capital to the Mount Vernon-Woodberry Cotton Duck Company, then heavily indebted to the Consolidated Company and others. The Consolidated Company was passing through a period of unprecedented conditions, notably (1) the high price of cotton, due to manipulation, which had forced a large part of the world's spindles to stop running, (2) defective operating methods." [1]

In 1910, a reorganization brought into power a new and abler management, so that the close of the year 1909 marked the turning point in the history of the cotton duck consolidation. It is, therefore, well to pause in the narrative, and consider the causes that led to its failure. In general these causes may be described under six relatively distinct headings.

[1] Circular letter of April 15, 1911. Digest in 92 *Chron.* 1313.

This same idea is expressed in an article in one of the textile trade journals. The Mount-Vernon Woodberry and Consolidated Cotton Duck Companies " found themselves early in the year 1910 in a difficult position where financial assistance, plant reorganization and additional management were required to cope with the disturbed markets for textiles, the violent fluctuations in raw materials, the inadequate and inefficient equipment, and the discouragement of its organization." 1913 *Am. Wool and Cotton Reporter*, 801.

Some of the operating conditions were deplorable. For example, in one southern mill, it was found that the purchases of cotton had all been made from a single agent, and that the prices paid averaged, during a long period of time between 1¼ and 1½ cents a pound above the market price. In one case it was found that the mill's cotton sampler was in the employ of the agent from whom purchases were made.

(1) Perhaps most prominent was the economic fact that the cotton duck industry does not lend itself readily to consolidation. There are no economies of large-scale production in the cotton manufacturing industry.[1] The large group of mills can manufacture no more cheaply than the single mill, even under the best conditions. And under the conditions which surrounded the Mount Vernon-Woodberry combination of mills, the small producer had the advantage at every point. (2) Although economic conditions were against the success of the cotton duck consolidation, the absence of good management was no less a factor in determining its failure. From the very first, the men in the direct control lacked the requisite ability to manage with even fair success a large group of cotton mills. Added to this inherent deficiency, there was constant friction between the various interests. Petty dissensions arose, and there was little coördination of the various departments; the executive officers were accused by the others of mismanagement, and their freedom was hampered by annoying restraints. The Presidency was changed successively in the hope of obtaining the requisite ability and unity of management, but the changes, as well as the successive financial readjustments, failed to produce either a harmony of interests or a unity in administration. (3) Among the detailed causes of failure, the first to be mentioned is the inadequate allowance for depreciation, already noted several times. The effect of the policy of under maintenance showed itself most conspicuously toward the end of the period, when, like the "one horse chaise" all the mills needed rehabilitation at one time. (4) Another cause lay in the fact that the pur-

[1] This is an interesting condition. The writer has been told by a mill operator of wide and successful experience that the cheapest method of production is by small mills, each of which is the proper size to obtain the maximum efficiency. This was, he reported, about 30,000 spindles for a coarse goods mill and about 60,000 for a medium goods mill. Mills of these sizes could be managed easily by superintendents of ordinary ability, who could watch the detailed operation, so as to eliminate the small wastes and yet who had ample opportunity to obtain all the economies of a mill of any larger size. Such a superintendent of ordinary ability could be found without much difficulty at a fair salary, whereas a general manager, capable of managing a large mill, or group of mills, was very rare and would command a salary all out of proportion to the superintendent for the smaller mill.

chasing agents of the mills were notoriously poor cotton buyers. Although a fact like this can be stated only in relative terms, the writer of this narrative received reports from six prominent men in the industry that the buying of cotton for the Mount Vernon-Woodberryand Consolidated Companies was unwisely conducted, and showed distinctly less than the average skill exercised by cotton buyers. Where, as in the manufacture of coarse goods, the cost of raw material represents a large percentage of the total selling price, the skilful purchase of cotton is a matter of primary importance.[1] (5) The combination suffered from inadequate banking facilities. Every textile manufacturing company is obliged to be a large borrower on the open market, in order to carry stocks of cotton and finished goods in warehouses. At first the presence of the income bonds of the Mount Vernon-Woodberry Company impeded the free sale of the Company's notes. Moreover, the banks in Baltimore, where the men and the Company were best known, were not accustomed to large volumes of cotton mill obligations. The Company's notes had to be sold, therefore, in the wider market of New York, or in Boston, where mill paper is well known.[2] (6) Last to be mentioned, but perhaps not least, were the conditions under which

[1] This fact is further attested by internal evidence. One of the chief causes leading to the retirement of the first President lay in his mistakes in the buying of cotton. The conspicuous losses of 1909 were caused by failure to cover contracts on the eve of the Patten corner. The tendency to speculate in cotton is one of the most serious and disastrous causes of failure among cotton mill operators. Generally they do not recognize that the management of a cotton mill requires distinctly different business ability than that demanded by a man who can anticipate correctly the price movement of a world staple. Once one of the Directors, — not on the operating side of the Consolidated Cotton Duck Company was asked if the management "were covered on cotton." He replied, "I don't know, but however they are, they are sure to be wrong." This shows the lack of confidence in the buying of cotton, even in the Company itself.

[2] For example, Chairman Warfield said at the annual meeting of February 19, 1906, according to report, "In a few directions here in Baltimore financial assistance has been given the Company, but it has had to depend largely upon New York and Boston to finance its current business, which it should not have been called upon to do."

According to reliable but confidential advices the Company found great difficulty in negotiating its paper in New York. One advice, in 1908, stated that the Mount Vernon Company sometimes borrowed directly on cotton.

the securities were issued, and the subsequent concern of the management over the stock market quotations. The combination was originally conceived largely for the purpose of promoters' profits, but the men in control were not able to dispose of the securities to the Baltimore investors as had been anticipated. Subsequent troubles over the income bonds, successive reorganizations, and the continual falling off of profits prevented the original interests from liquidating their holdings, except at a substantial loss. Their attention centered, therefore, much more on the market price of the Company's securities than on the operating success of the mills as a permanent manufacturing enterprise.

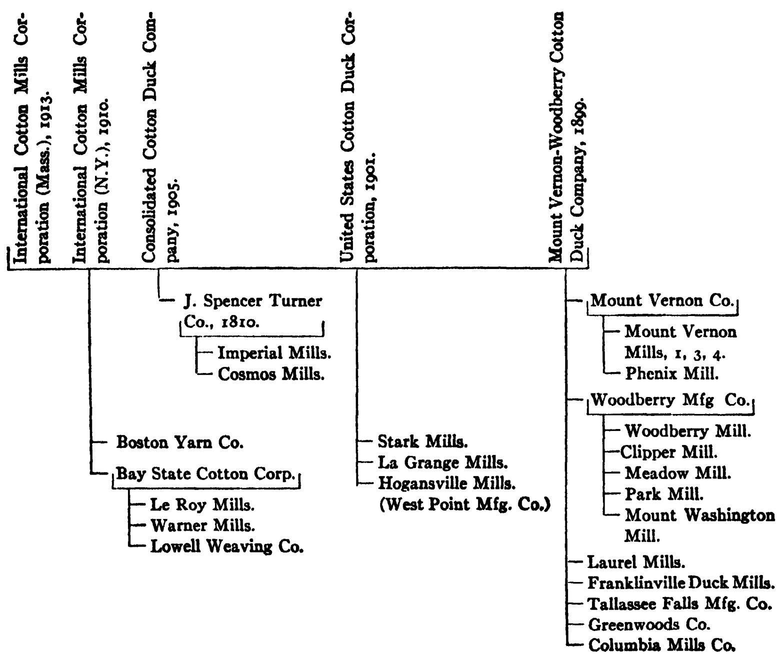


TABLE GIVING EARNINGS OF THE MOUNT VERNON-WOODBERRY AND THE CONSOLIDATED COTTON DUCK COMPANIES

Half Year Ending	Total Sales	Net Manufacturing Income	Current Interest, Gen. Exp. and Inter. on Tallassee Falls Mortgage ($15,000)	Net Profit (manufacturing)	Percentage Net Profit to Outstanding Capitalization (Semi-Annual)	Percentage Net Profit to Total Sales	Interest on Outstanding Bonds	Balance after Fixed Charges
					%	%		
June 30, 1899	....	....	....	$593,703	....	....		
Dec. 31, 1899	....	. .	....	914,148 [1]	4.0	. .	$175,000	$739,148
June 30, 1900	....	....	. .	759,380	3.4	....	175,000	584,380
Dec. 31, 1900	....	....	....	353,620	1.5	....	175,c00	178,620
June 30, 1901	....	....	....	−201,526 [2]	....	. ..	175,c00	−376,526 d.
Dec. 31, 1901	....	....	....	211,758	.9	.. .	175,000	36,758
June 30, 1902	$3,970,564	$458,492	$120,164	338,328	1.5	8.5	175,000	163,328
Dec. 31, 1902	3,153,312	342,150	165,008	177,142 [3]	.8	5.6	175,000	2,142
June 30, 1903	3,561,110	404,471	156,090	248,381	1.1	7.0	175,00o	73,381
Dec. 31, 1903	3,895,442	342,508	137,441	205,157	.9	5.3	175,000	30,157
June 30, 1904	3,482,014	311,402	127,817	183,585	.8	5.3	175,000	8,585
Dec. 31 ,1904	2,92c,964	342,198	112,523	229,675	1.0	7.8	175,000	54,675
Average for 5½ years (per year)								$196,548

THE CONSOLIDATED COTTON DUCK COMPANY, INCLUDING ALL THE MILLS

June 30, 1905	$4,660,837	$567,744	$167,247	$400,497	1.9	8 6	$175,000	$225,497
Dec. 31, 1905	4,697,180	652,123	135,447	516,676	2.3	10 9	188,225	328,451
June 30, 1906	5,150,583	782,293	151,493	630,800	2 8	12.2	188,225	442,575
Dec. 31, 1906	4,874,241	815,104	144,023	671,081	3 0	13.8	204,741	466,340
June 30, 1907	5,420,340	761,854	129,470	632,384	2.8	11.6	213,075	419,309
Dec. 31, 1907	5,201,047	608,191	110,010	498,181	2.2	9.6	212,925	285,256
June 30, 1908	3,309,197	442,765	107,465	335,300	1.5	10.1	212,925	122,375
Dec. 31, 1908	3,607,527	510,246	118,620	391,626	1.7	10.9	212,775	178,851
June 30, 1909	3,668,037	399,162	117,000	281,562	1.3	7 7	212,775	68,787
Dec. 31, 1909	3,967,342	−244,470 d.	117,902	−362,372 d	..	....	212,625	−574,997 d.
Average annual net profit, after all interest charges, for the five years								$392,489

Note. — The total sales and net manufacturing income were not published prior to 1902.

[1] Estimated on the basis of $6c9,434 for four months ending Dec. 31, 1899.

[2] This figure has been obtained by a process of deduction, and rests on indirect evidence. The Company published no statement of earnings for the half year ending June 30, 1901, — as it did before and after, — nor for the entire year 1901. In the Reorganization Committee (Consolidated Cotton Duck Co) plan of May 8, 1905 occurs the following statement, — "The average net profits of the Mt. Vernon Co. for the period (3½ years, ended December 31, 1904) averaged $145,coo per year after payment of interest on the outstanding first mortgage bonds and on the underlying bonds. It is, however, only proper to state that . . . if the period for which the earnings of the Mt. Vernon Co. are averaged be extended so as to include the full manufacturing year of 1901, only the last six months of which were included in the 3½ year period above referred to, the average yearly earnings of the Mt. Vernon Co. would be reduced from $145,000 to about $38,000." Now the average net earnings, after interest charges, are not $145,000 but $105,436 for the 3½ years ending December 31, 1904. They could be said to be $145,578 if the Reorganization Committee charged to surplus instead of net income account the two charges, — aggregating $140,498, — for 1902 mentioned in the succeeding note, — correction of inventory $60,682, repairs of dam $79,816. Yet the auditors of the company admitted both as proper charges to net earnings in their report for year ending 1902. But taking $145,578 as the average net profits after all interest charges for the 3½ years ending December 31, 1904 and $38,000 as the average net profits, after all interest charges, for the four years ending December 31, 1904, it appears that the net deficit, after all interest charges, for the six months ending June 30, 1901 must have been $376,526. Deducting the semi-annual interest of $175,000 on the Mount Vernon-Woodberry First Mortgage bonds it appears that the net manufacturing deficit must have been $201,526.

[3] After allowing $60,682 as correction to inventories and $79,816 for replacement of dam. These charges to net income were not admitted except in the statement of the entire year. The semi-annual statements would probably be more nearly correct had these charges been distributed through both half years.

CHAPTER XIV

THE INTERNATIONAL COTTON MILLS CORPORATION

Distress of the Consolidated Cotton Duck Company, 378; the Bay State Cotton Corporation and its constituent companies, 379; acquisition of Boston Yarn Company by the J. Spencer Turner Company, 381; International Cotton Mills Corporation syndicates, 382; acquisition of public holdings of Bay State Cotton Corporation stock by the International Cotton Mills Corporation, 385; issue of new notes to bankers, 386; summary of reorganization of 1910, 387; difficulties confronting the new company, 390; plan of reorganization of November, 1912, 394; failure of the plan of November, 1912, 396; provisions of the reorganization of 1913, 396; ends accomplished by the reorganization, 397; sacrifices of the various classes of stockholders, 402; summary points from the entire history of the cotton duck consolidation, 406.

CHRONOLOGICAL SUMMARY

1909. Threatened crisis of the Consolidated Cotton Duck Company.
Organization of Bay State Cotton Corporation.

1910. Acquisition of Boston Yarn Company by Consolidated Cotton Duck interests.
Formation of the International Cotton Mills Corporation syndicates.
Incorporation of International Cotton Mills Corporation.

1911. Issue of bankers' notes.

1912. Circulation of a plan of reorganization (November).

1913. Reorganization of International Cotton Mills Corporation of New York into a Massachusetts Corporation.

1914. Default in Mt. Vernon-Woodberry bond interest.

WITH the opening of the year 1910, the Consolidated Cotton Duck Company faced a choice between bankruptcy and a drastic reorganization. It was using about 60% of its spindles, and its operating expenses were increasing in the face of falling prices.[1] The business of the half-year ending December 31, 1899 had shown a manufacturing deficit of over $350,000; this, added to the interest on the underlying bonds, made a deficit of $575,000. The old Mount Vernon-Woodberry Company was also, — to use the language of one of its officials, — "on

[1] The Mount Vernon Company was also confronted by costly and harassing litigation by a few of its income bondholders. Details, see p. 393, note.

the brink of disaster."[1] The early policy of the management to pay dividends and income bond interest when conservatism would have prompted otherwise had borne fruit in under-maintained mills and consequent high operating costs.

To obtain relief the management decided to enter upon the manufacture of automobile tire cloth which had shown the largest margin of profit among the coarse fabrics. It was about to equip one of its mills with suitable machinery, but the problem of management became a serious one, for Thomas M. Turner, who had just succeeded Charles K. Oliver in the Presidency,[2] did not possess superior executive ability. The Chairman of the Board of Directors then looked about for some means of procuring a new management, a way of entering the tire cloth business, and last, but by no means least in importance, additional capital. The result was the purchase of a new selling agency, a thorough-going change in the personnel of the management, the amalgamation with important New England interests, and finally a drastic reorganization.

The management turned to Myron C. Taylor and P. T. Jackson, Jr., of the Boston Yarn Company which then acted as the selling agents for the Bay State Cotton Corporation, a consolidation of a tire cloth weaving mill and two yarn mills. The history of these corporations is somewhat complex. The Lowell Weaving Company had been originally controlled by P. T. Jackson, Jr.,[3] of Boston. He interested Myron C. Taylor of New York in the enterprise and together they bought some old buildings at Leroy, New York,[4] and refitted them as yarn mills.

[1] Quotation from Hambleton & Company's letter, quoting one of the Cotton Duck Company's officials.

[2] Charles K. Oliver had held the office since Trenor L. Parks had retired. On December 3, 1909, Turner became President and Oliver, Vice-President, — Oliver, however, continued in the active management. Oliver sold the Columbia mill to the Mount Vernon-Woodberry Cotton Duck Company, at the time the latter was promoted. He led the Company into the Patten corner with uncovered cotton.

[3] Mr. Jackson came from a family of manufacturers, earlier prominent in the New England textile industry. He himself had been trained in the industry and had already showed executive ability and skill of management in the building up and operation of cotton mills.

[4] Previously used as a malt house.

They leased — later acquired — the Warner Cotton Mills in Newburyport.[1] Mr. Jackson and his associates formed, in 1908, the Boston Yarn Company with a capitalization of $100,000 to act as the selling agent for the three mills. Twenty-year selling contracts were then arranged,[2] and through the high grade of the Lowell Weaving Company's product the Company became the second largest distributor of tire cloth in the United States. The selling agency was successful and its earnings were "conservatively estimated for the year 1910, at $110,000."[3] In 1909, Jackson and Taylor, together with Charles M. Warner, formed the Bay State Cotton Corporation[4] which took over the Lowell Weaving Company and the two yarn mills. The authorized capital of the Bay State Corporation was $1,500,000. Of this amount $500,000 was classed as "seven per cent first preferred," $300,000 of this was sold to Massachusetts investors and trustees on the basis of its security and liberal yield,[5] and the remaining $200,000 was bought by Jackson and his associates. Of the rest of the $1,000,000 of capitalization, half was classed as "second preferred" and the other half was called "common."[6] Of the two junior

[1] Charles M. Warner helped to finance the purchase of these mills. For Mr. Warner's connection with the Corn Products Company and the American Malting Company and the Asphalt Company of America, see pages 104, 272, 446.

[2] Letter of P. T. Jackson, Jr., to syndicate managers, dated May 25, 1910. Confidential Prospectus, International Cotton Mills Corporation, p. 6.

[3] *Ibid.* This estimate, however, was based partly on profits secured through intercorporate sales. The Lowell Weaving Company, as a tire cloth mill, took the yarn from the Leroy and Warner mills.

[4] They had Frank J. Hale and Rodman P. Snelling of the Saco-Pettee Company, manufacturers of textile machinery, as their associates.

[5] The first preferred stock was fortified by a particularly strong agreement. "The First Preferred Stock, to be issued for cash, and to be entitled to a preferential cumulative dividend at the rate of three and one-half per cent (3½ %) semi-annually, and no more, payable March 1 and September 1, out of the income, to be paid if earned. It shall be callable at $110 per share. In the event of liquidation it shall be a first charge on all properties of the Company. It shall be entitled to voting power on an equality with the second Preferred and Common stock. It shall not be increased and no bonds or other form of funded indebtedness and no other stock shall be given a preference ever it." Extract from Agreement of Association.

[6] The second preferred carried 7 % preferential dividends over the common; after the common stock should receive 6 % all dividends thereafter were to be

securities, approximately $300,000 of the second preferred and $400,000 of the common stock went directly to the owners of the three mills. The rest remained in the treasury.[1] The $500,000 of first preferred stock represented money added in order to enlarge the business, and the $700,000 of junior securities represented the actual value of the three constituent mills as shown by an appraisal of the American Appraisal Company. There were involved in the organization of the Corporation little over-capitalization and no promoters' profits.

Some time in February, 1910, the management of the Consolidated Cotton Duck and the J. Spencer Turner Companies entered into negotiation with the management of the Boston Yarn Company looking toward its purchase. As a result, the stock of the Boston Yarn Company was acquired in March, 1910, by the J. Spencer Turner Company through the issue of approximately $250,000 of the J. Spencer Turner Company's debenture bonds remaining in the treasury. These bonds, though they paid 6% in interest, were quoted well below par.[2] At the same time — and what was, perhaps, of greater value than the Yarn Company itself — the management of the Consolidated Cotton Duck Company secured the active coöperation of Myron C. Taylor and his associates. At the time of the acquisition of the Boston Yarn Company, it was not planned to increase immediately the scope of the Consolidated Cotton Duck Company; yet, it was

divided between the second preferred and common stock. These provisions were of slight significance as the second preferred and common stock were held by the same group of persons.

[1] The distribution of securities at time of formation of Bay State Cotton Corporation, may be seen from the following table:

	First Preferred Stock	Second Preferred Stock	Common Stock
Public for Money	$300,000		
Mill Owners for Money	200,000		
Mill Owners for the Three Mills	....	$300,000	$400,000
Treasury Unissued	...	200,000	100,000
	$500,000	$500,000	$500,000

[2] The stock of the Boston Yarn Company had a book value, December 31, 1910, of $121.25 per share. 1910 International Cotton Mills Corporation Report, 21. The book value when the stock was acquired by the Turner Company was somewhat less. The J. Spencer Turner debenture bonds had a value of approximately 75%.

realized that an investment of new money in the mills of the Company was imperative. Finally, a group of syndicates was formed [1] which looked to the acquisition of a majority of the stocks of the Consolidated Company, in the interest of a new corporation, and to providing the latter in addition with working capital. On May 27, 1910, Augustus P. Loring, Esq., and Joseph B. Crocker, two Boston men, the former a lawyer and trustee, the latter a stockbroker, were constituted syndicate managers,[2] under a syndicate agreement which looked to the acquisition of 53.2% [3] of the Consolidated Cotton Duck Company's stock controlled by the management and largely owned by interests immediately under the control of the Chairman of the Board of

[1] In all there were three syndicates: (a) May 27, 1910, for acquiring majority (53 %) of Consolidated Company's stock and to supply between $2,000,000 and $3,000,000 working capital. (Succeeded in obtaining the majority holdings, but secured only between $1,500,000 and $1,800,000 money subscription.) (b) April 17, 1911, for acquiring minority of Consolidated Company's stock and $500,000 of new money. (Succeeded in obtaining about 40% of the stock, but little new money.) (c) April 17, 1911, confined to the common stock of the new Company.

[2] As syndicate managers each received $12,500 in money. Mr. Loring also received a considerable fee for his services in connection with the incorporation of the new corporation.

[3] The following are the essential parts of the syndicate agreement. This agreement was marked " Confidential " and did not get into the financial press.

"For the purpose of acquiring 61,000 shares of the Six Per Cent Cumulative Preferred Capital Stock, and 71,000 shares of the Common Stock, both of the par value of Fifty Dollars ($50) per share, of the Consolidated Cotton Duck Company, a corporation organized and existing under the laws of the State of Delaware, and of obtaining additional working capital, it is proposed that the International Company shall issue 52,875 shares of its said Seven Per Cent Cumulative Preferred Stock, and 45,375 shares of its said Common Stock, of the par value of One Hundred Dollars ($100) per share.

"The Managers are about to acquire said 52,875 shares of the Preferred Stock and said 45,375 shares of the Common Stock of said International Company.

" It is the purpose of the Agreement to form a Syndicate of Subscribers to purchase said Preferred and Common Stock from the Managers for the sum of Five Million and Ninety-three Thousand Dollars ($5,093,000), in the proportion of ten shares of said Preferred Stock and ten shares of said Common Stock for each and every One Thousand Dollars ($1,000) herein subscribed by the respective Subscribers hereto, and allotted by the Managers, if and when said stock shall have been delivered to the Managers."

Syndicate Agreement of May 27, 1910, paragraph 2. In a later paragraph the Syndicate Managers are authorized to sell the excess of 1,945 preferred stock to even up the common stock. (52,875 to be acquired, and 50,930 preferred stock only, required.)

The syndicate and much of the reorganization was arranged by Samuel Untermyer of New York. Mr. Untermyer had been counsel at the formation of the Consolidated Cotton Duck Company five years before. He also, after the Company was on its feet, exerted his influence to secure the Company banking connections.

Directors and his associates.[1] This stock was acquired by the syndicate for the International Cotton Mills Corporation presently formed. According to the exchange one share ($100 par) of new preferred and one share ($100 par) of common stock was to be given for every four shares of Consolidated Cotton Duck Company's preferred stock ($200 par)[2] and one share of new common stock ($100 par) for every four shares ($200 par) of Consolidated Cotton Duck Company's common stock.[3] Besides the deposit of stocks, the men close to the management were invited to subscribe to the International Cotton Mills Corporation's preferred stock at par with an equal bonus of common stock. It was hoped, in this way, to obtain from $2,000,000 to $3,000,000 of new working capital. So confident were the men in the management that they could obtain the money themselves for the underwriting, that they refused an offer from New York bankers to provide the $3,000,000 of new capital for a commission of $1,000,000 in common stock. The cash underwriting was not a great success, only about $1,700,000 being secured. At a later date, a new Syndicate Agreement of essentially the same tenor was extended to cover the minority holdings of Consolidated Cotton Duck Company's stocks. These minority holdings were taken over on exactly the same

[1] At the time, Charles K. Oliver, as Vice-President of the Consolidated Cotton Duck Company, wrote to the syndicate managers a letter for publication under date of May 25, 1910. "A valuation of the properties controlled by the Consolidated Company and the Mount Vernon-Woodberry Company was recently made by Messrs. C. R. Makepeace & Company, the well-known mill experts of Providence, R. I. The total valuation is $16,157,656. In this valuation by Messrs. Makepeace & Company, the value of the mill properties of the Consolidated group is placed at $3,377,221, and that of the Mount Vernon-Woodberry group at $12,780,435. . . . The net earnings, covering a period of 5 years to May 1, averaged yearly $400,000 after deducting interest on the Mount Vernon-Woodberry bonds."

[2] The Consolidated Cotton Duck Company's Preferred and Common stocks had a par value of $50.

[3] As per previous note the syndicate managers were to acquire 52,875 shares of new International Cotton Mills Corporation preferred stock and 45,375 shares of new common stock. The distribution of the new securities, both because of the complex terms under which the syndicates acquired the Consolidated Company's stock, and because the full conditions of the syndicates were not carried out, is very intricate. More specific details can be seen by referring to the table facing page 387.

terms as the majority of the stocks had been acquired. According to the prevailing market prices of the Consolidated Cotton Duck Company's securities, the new stocks of the International Cotton Mills Corporation were acquired by the stockholders of the old Company at a valuation of approximately $70 a share for the new preferred and $10 a share for the new common stock.[1] These exchange values are important in determining relative values as none of the new securities were placed on the market.

On July 28, 1910, the International Cotton Mills Corporation was duly incorporated under the laws of New York, and acquired from the syndicate managers over 50% of outstanding stocks of the Consolidated Cotton Duck Company. Shortly, the stock of the Boston Yarn Company was transferred from the J. Spencer Turner treasury to that of the International Cotton Mills Corporation. But the Bay State Cotton Corporation remained separate and distinct without connection with the new International Company except indirectly through the Boston

[1] In estimating the cost of the new International Corporation's securities, the only basis of judgment is the market prices of the old Consolidated Company stocks given in exchange. During 1910, the market price of the common stock of the Consolidated Cotton Duck Company had ranged from $2.50 to $7 a share with an average, including both bid and asked prices, of $5 a share; but a purchaser was difficult to obtain at even nominal prices. The market price of the preferred stock had ranged with considerable fluctuations between $15 and $25 a share, with an average of about $20. At the time the new International Corporation was being incorporated, July, 1910, the market price was $20 asked, $18 bid, a share. As the syndicate participants were to receive one new share of International Cotton Mills Corporation's common stock for each four shares of Consolidated Company's common stock, it seems quite fair to estimate the actual market value of the new common stock as at least $10 a share. The preferred stockholders of the Consolidated Company received one share each of International preferred and common stocks for every four shares of old preferred stock of the Consolidated Company. These four old shares had a market value of approximately $80. In the first Loring-Crocker syndicate agreement it was stated that, in determining the prices at which the International preferred and common stocks should be sold by the managers, it was agreed " that for such purpose the cost to the syndicate of each share of the preferred stock is three (3) times the cost of each share of common stock." As the syndicate subscribers obtained one share of preferred and one of common for each $100 subscribed, it would indicate a presumptive value of $75 for the preferred, and $25 for the common stock. From other evidence, it is clear that these figures represented an over-estimation of the value of the common stock, and a slight over-estimation of the value of the preferred stock at the time of the agreement.

Yarn Company. During the summer of 1910, however, the textile industry was at a low ebb, and the Bay State Cotton Corporation found itself confronted with maturing obligations and adverse market conditions, difficulties that could be relieved only through securing new capital. In the emergency the management welcomed the advances of the newly created International Cotton Mills Corporation, in which Mr. Taylor was already a Vice-President and member of the Board of Directors.[1] In conference between the two interests, terms of exchange were arranged for the outstanding securities of the Bay State Cotton Corporation. The first preferred stockholders of the Bay State Corporation were offered one and one-tenth shares (110%) of new International Corporation's preferred stock; the second preferred holders were offered one share (100%) of the new preferred stock, and the common shareholders of the Bay State Corporation were offered nine-tenths of a share, 90% of their stock, in the common stock of the new International Cotton Mills Corporation. Mr. Jackson and his associates exchanged their securities on this basis. In this manner the International Cotton Mills Corporation acquired over 60% of the outstanding stocks of the Bay State Cotton Corporation.[2]

There still remained, however, outstanding some $300,000 of the Bay State Cotton Corporation first preferred stock held by Massachusetts investors and trustees, and the Treasurer of the Corporation wrote to the holders of this stock, reciting the offer already made by the International Cotton Mills Corporation. "It is very much to the interest of all Bay State Stockholders," the letter states, "that they transfer their shares for those of the International Cotton Mills Corporation, as the transaction was more advantageous to the Bay State Stockholders than to those of any other Company participating in the

[1] There is reason to believe that Messrs Jackson and Taylor did not fully comprehend the dilapidated condition of the Consolidated Company's mills, else they would not have sold the Bay State Corporation on these terms.

[2] Of the $500,000 first preferred, Mr. Jackson and Mr. Taylor and their families and business associates controlled approximately $200,000. This was all exchanged. Of the $300,000 outstanding second preferred and $400,000 common, all that was controlled by the management was exchanged, but about 8% — mostly owned by the stockholders of the underlying mills — was not exchanged.

merger."[1] As the stock of the new Corporation was taxable to Massachusetts investors, among whom it was almost entirely held, whereas the Bay State Corporation's stock was not, and as there was a feeling that the exchange was not desirable from the point of view of security, only a very few stockholders consented to the proposal.[2]

The new interests were still unsuccessful in securing as much working capital as they had anticipated. Accordingly, arrangements were concluded with Blair and Company of New York

[1] Letter of P. T. Jackson, Jr., to Bay State Stockholders, pp. 3 and 4.

[2] The merger of the Bay State and International Corporations appeared to be desirable from the point of view of the former, considering its interests as a whole. Yet from the point of view of the first preferred stockholders there were serious doubts of its wisdom. As explained in a previous note (foot of page 384) the new International Cotton Mills Corporation's preferred stock cost the stockholders of the old Consolidated Cotton Duck Company not over $70 a share. The Bay State first preferred stockholders paid originally $100 in money for their shares. As they were offered 110 % in new International preferred stock, the latter represented a cost to them of approximately $89.

The representations made to the Bay State first preferred stockholders were not such as would enable them to form independently an intelligent judgment of the new enterprise. The letter referred to above gives the balance sheet of the new International Corporation followed by a list of the mills which it controlled. Yet it makes no mention in the balance sheet or elsewhere in the letter of the underlying bonds of the Mount Vernon-Woodberry Company, although all their mills are included in " the completed list of mills." The letter states that the exchange " affords to the Bay State stockholder a very great additional security for his investment." This was true in regard to the new working capital and the mills of the Consolidated Company not covered by the Mount Vernon-Woodberry mortgage. It certainly was not true as regards the mills covered by the Mount Vernon-Woodberry mortgage. The Bay State Corporation's first preferred stockholders were giving up a first lien to unincumbered, productive mills, said to be worth over twice the outstanding issue, in exchange for the stock ahead of which, on a large part of the mills, were bonds, then selling on an 8 % basis. (Net quick assets of the Bay State Cotton Corporation above current liabilities $355,818.71. Real estate, $903,986.13. Total quick assets of first preferred, $1,259,804.84. Balance sheet of December 31, 1910. Outstanding first preferred, $500,000. There were $7,803,000 Mount Vernon-Woodberry 5 % 1st mortgage bonds, 1949, in hands of public. Quotations during 1910, 69 % to 74 %.)

In the prospectus issued by the syndicate managers, there is a letter from Charles M. Warner, as President of the Bay State Cotton Corporation, to the syndicate managers, dated May 25, 1910, which says that " the valuation of the properties of the Bay State Company is $1,392,951. The net quick assets of the Company as of May 1, 1910, are $100,000. . . . The average net earnings for 1909 and 1910 (balance of 1910, estimated) are $143,000."

whereby the bankers purchased $2,000,000 new 6% five-year notes at par, in consideration of a commission of $1,000,000, par value, in common stock of the International Cotton Mills Corporation. These notes were then offered by Blair and Company of New York to the public for 98.[1] The agreement under which these notes were issued bore heavily upon the International Cotton Mills Corporation, and seriously affected its subsequent financial policy.[2]

The events just narrated that led up to and followed the formation of the International Cotton Mills Corporation actually constituted a thorough reorganization of the old cotton duck consolidation. And although these events were spread over the period of a year and a half and are more or less independent of each other, they may be looked upon as parts of a single reorganization consummated in four distinct steps. The first step was the acquisition of a majority of the stocks of the Consolidated Cotton Duck Company, together with some new working capital; the second was the acquisition of a majority of the stock of the Bay State Cotton Corporation and the transfer of the Boston Yarn Company from the J. Spencer Turner Company to the newly formed International Cotton Mills Corporation; the third, the acquisition of nearly all of the minority holdings of the Consolidated Corporation on the same terms as the majority interest had been acquired; the fourth, the enlistment of new working capital and the coöperation of independent bankers. The financial results of these steps may be seen from the table on the following page.

It will be noted, from an inspection of the table, that besides the two primary motives of the reorganization, — the change of management and the provisions for new working capital, — the reorganization accomplished certain very valuable results.

[1] The circular under which these notes were offered was conspicuously lacking in the amount of information it contained.

[2] The International Cotton Mills Corporation obligated itself not to place any new mortgage on its mills, to maintain its quick assets at least equal to its liabilities including the $2,000,000 of notes, to redeem $1,000,000 of the notes a year, and not to part with any of the subsidiary securities (except Bay State Cotton Corporation's first preferred stock). Agreement of July 13, 1911, International Cotton Mills Corporation with Mercantile Trust Company, Article 3.

The entire financial organization was put on a new and simpler basis. With the exception of the old Mount Vernon-Woodberry first mortgage bonds, which were still retained, the reorganization was a movement in the direction of a greater conservatism. Unfortunately the interests of the old Consolidated Company were too liberally provided for, since by no subterfuge of appraisal or earning capacity could the Company's stocks be considered worth the prices at which the Loring-Crocker syndicates acquired them. The old Mount Vernon-Woodberry Company's bondholders should have been assessed or their mortgage lien refunded into the preferred stock. In all probability a default on the interest of the Mount Vernon Company's bonds, — the reasonable consequence of the deficit of 1909 and the depreciated condition of the Company's mills, — would have led to a more comprehensive recasting of the finances of the various companies, and a reorganization following such a default would have rendered unnecessary the later reorganization of 1913 in which the preferred stockholders and members of the Loring-Crocker syndicates were ruthlessly sacrificed in the interest of the old bondholders. It is important to note that neither the fixed charges nor the outstanding capitalization were apparently decreased; but the heavy floating debt of both the Mount Vernon and the Consolidated Cotton Duck Companies was greatly reduced through the investment of new money. Moreover, much of the newly invested money was paid for by the preferred and common stocks of the International Company, and therefore involved no new fixed charges.[1]

No sooner was the Jackson-Taylor management[2] in control than they began the rehabilitation of the physical property of

[1] As it developed later, the weakest feature of the reorganization was that no more new capital was provided, that over half of the new capital — the Blair notes — was so carefully guarded as to unduly restrict the new company. But this error was occasioned by a failure on the part of the new management to realize fully the dilapidated physical condition of the old Mount Vernon and Consolidated Companies' mills and the large sum necessary to rehabilitate the property. It was believed that a large part of the new equipment could be paid for through earnings.

[2] The management was changed throughout and J. D. Armitage, who had had wide experience in New England textile properties, became general manager for all of the mills, except that P. T. Jackson, Jr., continued his active management of the Bay State Group.

the old United States and Mount Vernon-Woodberry Mills. Large sums of money were invested in new machinery for the Stark Mill — in fact the mill was practically refitted. The new management made aggressive expenditures for modern equipment, paying for it, partly with the new money and partly with notes which it was anticipated could be liquidated through earnings. The general credit of the Company had been strengthened by the reduction in the outstanding floating debt.

The rehabilitation of the duck mills was made at a time of prosperous business so that the old mills, only partially refitted, were able to show a substantial manufacturing profit. The calendar year of 1911, during only a part of which the improved equipment was in operation, showed net earnings for the International Cotton Mills Corporation, after the payment of underlying fixed charges, of $388,936, out of which $60,000 was paid as interest on the five year 6% convertible notes [1] and $295,825 in dividends. These earnings were nevertheless below what was expected, for at the time Blair and Company sold the five year 6% convertible notes, in the summer of 1911, they stated, on the authority of a letter from the President,[2] that "it is estimated that the surplus net earnings of the International Cotton Mills Corporation and its subsidiary Companies will this year approximate $600,000." [3] The earnings were also far below

[1] Interest for one-half year, July 1 to December 31, 1911, on $2,000,000. The comparative income accounts for 1910 and 1911, as given in the *Commercial and Financial Chronicle*, were as follows: —

International Company	Year Ending December 31, 1910		Year Ending December 31, 1911
Net Income	$152,351		$388,936
Interest on 6% Convertible Notes	....		60,000
Net after Charges	$152,351		$328,936
Preferred Dividend (1¾%)	78,647	(5¼%)	295,825
Net Surplus	$73,704		$33,111

94 *Chron.* 1381.

[2] "Taking the Surplus Net Earnings of the International Cotton Mills Corporation and its Subsidiary Companies since its organization, together with subsequent estimates, I am confident that the Surplus Net Earnings of the International Cotton Mills Corporation and its subsidiary companies will this year approximate $600,000." Letter of Myron C. Taylor, President, to Blair & Company, dated June 30, 1911.

[3] Circular of Blair and Company offering the 6% convertible notes.

the estimates of the officers of the subsidiary companies made to the syndicate managers at the time of the formation of the International Cotton Mills Corporation,[1] when it was stated that the earnings would be not less than $1,500,000. The showing was, however, far better than the large deficit of the Consolidated mills for 1909 would have led one to expect. Had the Bay State group of mills represented a larger proportion of the Company's operating spindles, the showing would have been correspondingly improved.

During the first part of 1912, the business of the International Company's mills was in an improved condition with increased sales, but without correspondingly larger profits.[2] Results failed to justify the courageous expenditures for mill equipment; and toward the end of the year it became clear that the refinancing of the mills had not been sufficient. The new management had over-estimated the physical value of the Mount Vernon and the Stark groups and under-estimated the amount of new money that would be necessary to thoroughly rehabilitate them. Then, too, the internal financial arrangements of the various subsidiary companies were in an unsatisfactory condition. Large sums of money had been advanced to the Mount Vernon-Woodberry Company by the Consolidated Cotton Duck Company;[3] notes

[1] "It is conservatively estimated by the officials of the respective companies, in which estimate I concur, that the net earnings (fixed charges deducted) of the International Cotton Mills Corporation from its manufacturing and selling companies should be not less than $1,500,000." Letter of Myron C. Taylor to Augustus P. Loring, Esq., and Joseph B. Crocker, Esq., Syndicate Managers, dated June 1, 1910. Printed in the *Prospectus*, International Cotton Mills Corporation.

[2] For the first six months of 1912, the following statement was made by the *Commercial and Financial Chronicle*, — "Combined earnings, including associated companies $808,527; fixed charges, $330,525 (these represented $200,000 in the Mount Vernon-Woodberry first mortgage bonds and $120,000 on the 6 % convertible notes) leaving balance of surplus, $478,002."

[3] Difficulty was experienced in fixing the liability for the improvements and renewals in the Mount Vernon-Woodberry mills, on account of the complications of the liens of the two issues of bonds. An outline of the controversy was something as follows: —

In 1911, the poor condition of the Mount Vernon-Woodberry Company's equipment called for immediate attention from the new owners of the Consolidated Cotton Duck Company who indirectly owned the equity in the Mount Vernon-Woodberry Company's mills. But the latter company was already under very

were negotiated with a variety of makers and endorsers so that the limits of liability of each company were difficult to determine.[1] The subsidiary companies had obtained large advances from the machinery manufacturers and title to some of the new equipment would be jeopardized by any default in payments. The conditions under which the five year convertible 6% notes were

heavy obligations to the Consolidated Company, the Board of Directors of which were unwilling to make further advances to their subsidiary because of the direct lien of the old Mount Vernon-Woodberry Company's bondholders. Yet new equipment was an imperative necessity. As a result of negotiations, the Consolidated Company consented to advance machinery to the value of $300,000, which was installed in the Mount Vernon-Woodberry Company's mills according to the following schedules: —

Mount Vernon Mill, No. 1	$63,700
Mount Vernon Mill, No. 3	65,196
Clipper Mill	28,550
Meadow Mill	54,445
Woodberry Mill	14,935
Druid Mill	2,913
Mount Washington Mill	2,308
Tallassee Falls Mill	68,904
Total	$300,951

The title of this machinery remained in the name of the Consolidated Cotton Duck Company, and the Mount Vernon-Woodberry Company agreed to pay for it as conditions would permit.

On December 11, 1911, the Mount Vernon-Woodberry Company sold its old Greenwood Mills at New Hartford, Connecticut, — previously dismantled, — to the Draycott Mills, receiving in payment a note of the latter corporation for $300,000. The Mount Vernon-Woodberry Company then applied to the Trustees of its First Mortgage and Income Bond Mortgage to be allowed to use this note of $300,000 in payment to the Consolidated Company on the ground that the original mortgages provided that the proceeds realized from the sale of any of the property mortgaged could be used for the betterment of any of the mortgaged property. The Trustees refused to comply with the request on the ground that the betterments had already been made, that the mere installation of the new machinery brought it under the lien of the two mortgages. The Mount Vernon Company then applied to the Circuit Court to compel the Trustees to permit the note to be used as payment for the machinery. Both in the lower Court and in the Court of Appeals the position taken by the Trustees was upheld.

[1] Early in 1912, certain New York banking institutions reported unfavorably on the Company, giving various reasons. Apparently the difficulty encountered in the internal financing of the Company tended to disturb confidence in its general credit.

issued seriously restricted the Company's borrowing power [1] and made impossible any new financing until those notes should have been paid or refunded. The payment of dividends on the preferred stock at this time must be regarded, on the whole, as unwise. The full quarterly dividend of 1¾% was paid for three successive quarters,[2] but decreased to 1% in October, 1911, and finally passed altogether in April, 1912. These dividend disbursements — amounting altogether to some $400,000 — were paid at times when the Company had imperative need for its entire working capital. The greatest service the Company could render its stockholders would have been to reduce the outstanding obligations and thus lessen the necessity of seeking for new capital and the hazard of another reorganization. When that reorganization came, in the summer of 1913, it bore heaviest on these very stockholders, and the sacrifices they made then far exceeded the amount they had received in dividends. The policy of conservatism was wisely adopted by the management, in the spring of 1912, when they passed the dividend on the preferred stock, at the very time their earnings were greatest.[3]

[1] Quick assets must be equal to at least the quick liabilities in which these notes were included, although they did not mature for five years and were issued for the purpose of purchasing new equipment. In other words, the liability for the new machinery, purchased with the proceeds of the notes, would have to be regarded as a quick liability. Furthermore, a sinking fund of $100,000 a year depleted the working capital by just that amount each year.

[2] December 23, 1910; April, 1911; July, 1911.

[3] At the time the dividend was passed a note appeared in one of the Boston financial papers, which probably embodied a statement by the Company's management: —

"The passing of the preferred dividend by International Cotton Mills, the big New York and Baltimore controlled cotton mill consolidation, follows a reduction in rate from 7% to 4% last October. . . ."

"The present suspension, however, curious as it may seem, is not due to a business depression, although the company has had its share of this for 18 months. . . .

"The fact of the matter is that there has been a virtual boom in duck and allied coarse goods, which International makes, such as has not been seen since the days of the Japanese war. . . .

"But the money from this flood of new business will not be forthcoming for several months and in the meantime International is, therefore, obliged to conserve its cash resources. Although a 1% payment is only a matter of some $44,000, the company felt that it could better use the money in its business, particularly if the new rise in cotton presages a higher cost basis. Resumption of dividends is likely by fall or winter at the outside.

"Although International Cotton is overwhelmed by a host of underlying liens, which sap earnings and which are the remnants of the ill-starred and highly capitalized Consolidated Cotton Duck Co., it is going ahead manfully in maintaining its property. In the 22 months since formation $1,500,000 has been spent upon replacements and repairs."

Strange to say, at the very time when the business of the Company looked brightest, about May, 1912, there came the first suggestion of a reorganization. Some bankers in New York reported in a confidential statement, that the Company "very probably will have to reorganize." [1] Yet no steps in this direction were taken until the autumn of 1912, when the necessity for new money became so imperative that additional financing on a broad scale seemed the only means of reducing the heavy floating debt and of continuing the policy of refitting the mills. The need for more working capital was especially urgent, for the ordinary business of purchasing and manufacturing large quantities of cotton requires a liberal credit, fortified by ample reserves and net quick assets.[2]

[1] Source cannot be disclosed.

[2] The difficulties which the subsidiary companies were meeting, in seeking to rehabilitate the mills under the handicap of heavy prior liens and depressed general credit, is well illustrated by the litigation carried on by the outstanding income bondholders of the Mount Vernon-Woodberry Company.

Soon after the reorganization of 1905, the Consolidated Cotton Duck Company acquired over 96 % of the issue of $6,000,000 of Mount Vernon-Woodberry Company's income bonds. Certain holders of these bonds, however, refused to accept the terms of exchange proffered by the Consolidated Company. A large part of the outstanding bonds — $164,000 out of $234,000 — were owned or controlled by interests associated with the Colonial (then the Real Estate) Trust Company of Baltimore. The bonds had been acquired by these interests from the original Parks syndicate. (*Supra*, p. 341.) On July 31, 1906, an attorney representing a committee of the dissenting bondholders made demands on the Duck Company to buy the bonds at cost and back interest, — else suit would be initiated. The Company's Executive Committee refused the demand. Finally, in 1909, after the Committee had sought in vain to compel the Trustee to institute suit against the Mount Vernon-Woodberry Company for the payment of interest, the Committee brought suit in its own name against the Mount Vernon, the Consolidated and the Turner Companies in the United States Circuit Court for the District of Maryland. The Bill of Complaint alleged, among other things, that the Mount Vernon Company had (1) earned more than the payments authorized by the mortgage debt,— to wit, taxes, rentals, operating expenses, maintenance and the interest on the First Mortgage bonds, (2) made appropriations for depreciation which it was not authorized by the original mortgage to do, and (3) that the intercorporate relations with the Consolidated and Turner Companies were prejudicial to the good of the Mount Vernon Company and its income bondholders. The Committee declared that there had been a technical default in the interest payments on the income bonds, and prayed that the Court appoint a Receiver. The Mount Vernon-Woodberry Company, in answer, denied the allegations and asserted its right under the provisions of the original mortgage to accumulate a depreciation reserve. The

After considerable negotiation between the President and the Chairman of the Board of Directors on the one side and private bankers on the other a tentative plan of reorganization was finally reached in November, 1912, and announced in the Baltimore newspapers November 28, 1912.[1] A new corporation was to be formed, — presently called the International Cotton Mills of Massachusetts.[2] This new corporation would acquire all the assets of the old International Cotton Mills Corporation of New York. It would issue approximately $6,400,000 of second preferred 6% stock — entitled to no dividends for three years and thereafter to cumulative dividends — in exchange for the old preferred stock.[3] The Company would issue its own common stock in exchange for 33⅓% in par value of the old common stock. Additional capital would be raised by the sale of $2,000,000 of new first preferred 7% cumulative stock, with an equal bonus of common stock to the old stockholders, both preferred and common, and the sale of $5,000,000 in three year 6% notes

charges to depreciation had only amounted to $682,600, for a period of ten years. (*Supra*, p. 372.) The attorneys for the Mount Vernon Company somewhat sarcastically remark that the income bondholders "alternately weep over the alleged efforts of defendant to maintain the efficiency of its plant and deplore the alleged failure of defendant to sustain the value of the good-will of its business." (Answer of Mount Vernon Company, p. 50.) The criticism of bondholders, the principal of whose lien would not fall due for over forty years, of a charge to depreciation averaging $68,260 a year on mills costing over $11,000,000, is probably without parallel in the recent history of American finance. The entire controversy was referred to a special master of the Federal Court who, in general, upheld the position of the Mount Vernon-Woodberry Company. Judge Rose, in his decision, upheld the contentions of the Mount Vernon Company, that depreciation was a just and proper charge. See note 2, page 372.

Details of this note from Bill of Complaint and answers. Whitridge *v.* Mount Vernon Cotton Duck Company.

[1] See *The Baltimore Sun*, November 28, giving account of a meeting held on the 27th under the auspices of S. Davies Warfield. The general features of the plan of the reorganization were reviewed in much the same form as they were definitely announced four days later.

[2] The majority of the facts stated in this paragraph are derived from the Deposit Agreement of December 2, 1912, issued to enlist the support of the members of the old Loring-Crocker syndicates, which still held practically all of the stock of the International Cotton Mills Corporation of New York.

[3] Each old stockholder would receive 109 % in new second preferred stock. The 9 % was intended to partially compensate for the loss in dividends for three years.

at approximately 93½% to a syndicate of bankers comprising Lee, Higginson & Company and Blair and Company who would receive as compensation for their services $1,000,000 in new common stock. In brief the reorganization was to involve the refunding of the 7% first preferred stock into new 6% second preferred stock, the cancelling of two-thirds of the common stock and the acquisition of approximately $6,675,000 in new capital.[1] The general changes contemplated by the plan may be seen from the table on the following page.

As practically all the stock of the International Cotton Mills Corporation was held under the three Loring-Crocker syndicates, and the participation certificates were narrowly held by the comparatively few men who had subscribed, it was relatively easy to secure the necessary consent of the syndicate members to the reorganization. Accordingly, there was printed and distributed among the members a Deposit Agreement dated December 2, 1912, and in a short time practically all the members of the syndicate had assented to the plan or expressed their willingness to do so. But unforeseen difficulties arose. As is clear from the description of the measures proposed, no assessment on any of the security holders was contemplated. Yet the plan required the investment of nearly $7,000,000 of new money, upwards of $5,000,000 of which must surely be subscribed by the bankers and even more if the stockholders failed to take up their allotments of first preferred stock. Clearly the bankers held the key to the entire situation, for the investment of a large amount of money was essential to the success of the new corporation. They realized this and refused to continue the negotiations unless more advantageous terms were offered them, alleging that the earnings were not as great as had been anticipated, and the changed conditions of the money market of

[1] Certain minor features in the plan of reorganization call for brief comment. It was intended to exchange the J. Spencer Turner Company's 6% debenture bonds for new J. Spencer Turner Company's 7% preferred stock. This change was distinctly wise as it would improve the general credit of the new Company's principal selling agent. The five year 6% convertible bonds were to be refunded. A large part of the new capital was to be used in cancelling the intercorporate obligations and paying the machinery notes.

the spring of 1913 made the sale of the notes to the public more difficult.[1] Moreover, certain men, connected with the technical side of the business, never looked with favor on the plan because of its complicated structure and the large volume of securities to be issued. They had been trained to believe the simplest form of financing was the best for cotton mills and looked with suspicion upon the complex structure which the plan of December 2d set out to rear. As a result, the plan was set aside in the interest of a more drastic reorganization, having as its end a new corporation with the simplest financial form that the variety of old securities would permit. After long negotiations the Company, which was represented in the bankers' negotiations by its Chairman, announced an entirely new plan of reorganization. It was called the "modified plan" in the letter to the Committee mentioned in the Deposit Agreement,[2] but was, in reality, entirely different in essential particulars from the proposed reorganization plan of December 2, 1912. As this final plan led to one of the most, if not the most, complex reorganizations in the financial history of industrial corporations, it is advantageous to enter, in some detail, into its provisions.

Four purposes were accomplished by the reorganization. The new company — called hereafter the International Cotton Mills of Massachusetts — was supplied with nearly \$8,000,000[3] of

[1] There were undoubtedly foundations for both of these allegations. The complete earnings for the first part of the year 1912, which were all that were available when the arrangements for the first plan were under consideration, were better than for the second half of the year. Added to this was the serious change in the market for investment securities. Not only did the prices for high grade securities fall almost continually from November, 1912, to June, 1913, but corporations everywhere resorted to short term note issues as means of temporary financing until the general investment conditions should presage a better market for long term bonds. In the early part of the summer of 1913, in response to this condition, there was issued an unprecedented volume of short term notes which disturbed the normal market for this form of security and made difficult the sale of another issue of three year notes even on a 6½ or 7 % basis.

[2] Letter of S. Davies Warfield to " W. J. Casey and H. L. Smith, the Committee named in the Deposit Agreement, dated December 2, 1912, Baltimore." Letter dated April 19, 1913, and hereafter designated as letter of April 19, 1913.

[3] Of this gross amount, \$75,000 was required as the commission to a sub-syndicate for underwriting \$1,500,000 of the preferred stock; and \$1,900,000

new money, the greater part of which was immediately available for the payments on machinery and for new working capital. The old position of the United States Cotton Duck Corporation was restored, in so far as the International Corporation acquired the legal title to the Stark, Hogansville and La Grange mills and a stockholder's interest in the mill properties owned by the old Mount Vernon-Woodberry Company. The internal financial relations of the various subsidiary companies were much simplified. The stock interests representing the equities in the Mount Vernon and Consolidated Companies mills were reduced, so that the new Company emerged from the reorganization with little or no capitalization in excess of the actual physical value of its property. These results were accomplished only after intricate financing and numerous sacrifices on the part of the old stockholders.

The most important of the ends attained was the subscription of a large amount of money, for it came at a time when need of working capital was especially urgent and when the Company faced the necessity of meeting payments on new machinery to which it had acquired only a leasehold right. This new money was obtained from four sources. The bankers' syndicate, consisting of Lee, Higginson and Company, and Blair and Company, took $4,000,000 of a $5,000,000 issue of 6% five year notes,[1] paying the Company $3,600,000. A syndicate was formed[2]

(approx.) was required to pay off the old Blair and Company's convertible notes. The amount of new money, net, was therefore approximately $6,000,000.

[1] These notes were secured by a strong indenture which provided that while the notes were outstanding neither the new International Corporation nor the Bay State — which retained its separate existence — should "issue, guarantee or endorse any bonds, debentures, long time notes or similar securities, and will not mortgage or pledge any of the properties or securities which they now own." It was planned that these corporations should have no bonded debt, so that the notes were a first lien on the Stark, La Grange, and Hogansville mills, and a first lien on the Bay State group of mills except for the outstanding issue of $266,600 of first preferred stock.

[2] Managers: Robert F. Herrick, of Fish, Richardson, Herrick, and Neave, Attorneys; and Edwin Farnham Greene, of Lockwood, Greene and Company, textile mill engineers. As indicated by note 3 on the preceding page a sub-syndicate had to be formed to take over half the underwriting. It was arranged by the Chairman of the Board of Directors.

which underwrote $3,000,000 of first preferred 7% cumulative stock (with a bonus of the same amount of common stock) at par, without commission. The privilege was offered to the old preferred stockholders of subscribing to this syndicate to the extent of 30% of their holdings and to the old common stockholders to the extent of 15% of their holdings.[1] The sale of these stocks procured $3,000,000 for the new Company. In addition to the sale of the notes and preferred stock, the old J. Spencer Turner Company was provided with $800,000 in new capital, by the sale of $1,000,000 of its new preferred stock and the new Company was guaranteed $600,000 through the sale of $650,000 in underlying mortgages.[2] These two operations may be understood better in connection with the new internal financial operations, to be described presently, but they resulted, objectively, in an increase to the net working capital of the whole consolidation. The various sources from which the new capital was derived may be seen at a glance from the following table: —

Securities	Par Value	Rate of Sale	Total New Money
Five Year 6% Notes...	$4,000,000	90 %	$3,600,000
(Commission of Common stock to bankers)	1,200,000		
First Preferred 7% Cumulative Stock ...	3,000,000	100 %	3,000,000
(Bonus of Equal Amount of Common Stock)	3,000,000		
Preferred 7% Cumulative Stock of the J. Spencer Turner Company	1,000,000	80 %	800,000
Underlying Bonds and Notes	650,000	92½%	600,000
	$12,850,000		$8,000,000
Commission to sub-syndicate for underwriting $1,500,000 of preferred stock (Deduction)			75,000
Total New Money Available			$7,925,000

As a result of these transactions upwards of $8,000,000 of the new money was obtained. It involved a charge to the Company

[1] As most of the old stocks were held in one or another of the three Loring-Crocker syndicates, the old stockholders meant the holders of the participation certificates. The response of the stockholders was not encouraging, — which necessitated the formation of the sub-syndicate mentioned in the preceding note.

[2] The Tallassee Falls mills ($250,000) and the prior lien notes on the Columbia mills ($400,000). These securities had been in the treasury of the Consolidated Cotton Duck Company. On its liquidation they were taken over by the new International (Mass.) Corporation which then contracted to sell them to the bankers for not less than $600,000, prior to January 1, 1914.

in excess of 8%, presuming that the dividends on the first preferred stock were to be paid.

The second object obtained through the reorganization was a simpler internal financial structure. The intricate inter-corporate relations had resulted in an almost hopeless tangle of direct, indirect and contingent liabilities on the part of the various corporations. The first necessity, from the point of view of the Company's credit, was to separate those mills covered by the old Mount Vernon-Woodberry first mortgage bonds from those which were not encumbered by important underlying obligations. Accordingly, the new International Cotton Mills (Massachusetts) after paying off small mortgages of $145,000 on the Georgia mills,[1] acquired an absolute title to the old United States Cotton Duck Corporation's mills, — the Stark, the La Grange, and the Hogansville. For these mills it was the operating Company. It also acquired the stock and income bonds[2] of the Mount Vernon-Woodberry Cotton Duck Company from the old Consolidated Cotton Duck Company, which then ceased to exist as a corporation. In this way the International Company obtained whatever value lay in the equity of the old Mount Vernon-Woodberry Company's mills without assuming any obligation with respect to the first mortgage bonds. It pursued the same course toward the J. Spencer Turner, the Bay State Cotton and the two Canadian Companies; so that the new International Cotton Mills corporation became an operating company with respect to three of its mills of which it had a perfect title and merely a holding company for the stock of the other mills. To obtain this simplification many changes were required. The extinction of the Consolidated Cotton Duck Corporation alone involved intricate readjustments. It had made heavy advances to the

[1] $125,000 lien on the La Grange mill was immediately liquidated by borrowing the necessary money. The $20,000 notes of the Hogansville mill were gradually liquidated, — $5,000 at a time. The bankers insisted that these old liens should be removed, and that the three mills of the old United States Cotton Duck Corporation — the Stark, La Grange, and Hogansville — should be acquired by the new International Corporation free from all underlying burdens.

[2] 99.86 % of the stock and 96 % of the income bonds. For controversy concerning the outstanding 4 % of the income bonds, see *supra*, p. 393.

Mount Vernon-Woodberry Company, which the latter was in no position to pay;[1] it was directly or indirectly liable on notes issued by the Turner Company. As finally arranged, some of the new money was devoted to liquidating these obligations, and those that remained were taken over as assets by the Turner Company. The latter increased its common stock — all held by the International Corporation — from $500,000 to $1,795,-662.23 in order to create a liability in its own accounts, which could forthwith become an asset on the books of the holding Company.[2] In other words nearly $1,300,000 of old debt was

[1] At the time the obligations of the Mount Vernon-Woodberry Company to the Consolidated Cotton Duck Company were approximately $2,460,000.

[2] This ingenious method of financing can hardly call for commendation, and has an excuse only through the exigencies of accounting. As the Turner Company's common stock was entirely held in the treasury of the International, it was of little consequence whether its par value was $1 or $10,000,000. It had been fixed originally (in 1906 when the Turner Company was reorganized) at the convenient amount of $500,000, all having been issued directly to the Consolidated Company merely as compensation for guaranteeing the $2,000,000 of the Turner Company's debenture bonds. This nominal par value of $500,000 was increased by $1,295,-662.25 as a means of capitalizing that portion of the debt of the old Mount Vernon-Woodberry Company which was considered uncollectible. The common stock of the Turner Company represented no increased value or earning power; yet it appeared on the balance sheet of the new International Cotton Mills corporation as an asset of $1,795,662.25 (see statement below) when over two-thirds of the amount represented uncollectible debt, — the relic of the Mount Vernon-Woodberry Company's past misfortunes. In the published statement of the International Company, — on the basis of which the notes were sold by the bankers, — no explanation of the item was made, nor was any effort discernible to explain the basis of a large part of the Turner Company's assets represented by the Mount Vernon Company's notes. Such methods of accounting are without doubt technically correct. The books were audited on behalf of the bankers by Herbert F. French & Company, of Boston. Yet such technical evasions, without proper explanation, defeat the fundamental purposes of accounting, by leading to confusion in the interpretation of a statement. It has been remarked, and it is the firm conviction of the present writer, that methods of accounting between a parent company and its subsidiaries are prone to give rise to deceptive entries.

The date and structure of the statement are also somewhat peculiar. The auditors took the balance sheet of December 31, 1912, and made such changes as would be brought about by putting into execution the modified plan of May 19, 1913. In this way the statement failed to show the actual condition of the business at any one date. A new balance sheet, depending on a new inventory, would have required too much time, had the bankers wished to use it in the sale of their notes, — but a new balance sheet, correct at a single, definite moment of time,

capitalized, by merely increasing the par value of the Turner Company's stock on the books of the holding corporation; and $1,100,000 was taken over by the Turner Company as notes to be gradually liquidated by the Mount Vernon Company in the course of its business. In addition to its common stock the Turner Company authorized an issue of preferred 7% cumulative stock, which would amount, when the refunding was complete, to $2,450,000. Of this preferred stock $1,000,000 was

would have been the only form of statement that did not violate the logical principles of accountancy.

Assets		
Real Estate, Buildings, Plants and Machinery	$7,072,272.46	
Other Machinery owned, but leased to the Mount Vernon-Woodberry Cotton Duck Co.	720,997 58	$7,793,270.04
Current Assets.		
Bills and Accounts Receivable	$395,184 00	
Inventory	1,838,677.35	
Prepaid Insurance and Interest	50,153.90	
Cash	1,302,492.53	
Bonds and Notes of other companies, already contracted to be sold at not less than $600,000 cash prior to January 1, 1914	600,000.00	4,186,507.78
Securities owned, etc., representing chiefly equities in Subsidiary Companies, and valued on the books of the Company as follows:		
J. Spencer Turner Co., entire Common Stock	$1,795,662.25	
Securities carrying control of capital stocks of "Cosmos" and "Imperial" Mills	568,440 00	
Securities representing control of Mount Vernon-Woodberry Cotton Duck Co., etc.	3,536,257 60	5,900,359.85
Miscellaneous Securities		260,626 66
Total		$18,140,764 33
Liabilities		
Five Year 6% Gold Notes (authorized $5,000,000)		$4,000,000.00
Preferred Stock, 7% Cumulative (authorized $10,000,000)		3,000,000.00
Common Stock (authorized $10,000,000)		10,000,000.00
Outstanding balance of First Preferred Stock of Bay State Cotton Corporation (callable at 110)		266,600.00
*Current Liabilities:		
Accounts Payable	$652,197.33	
Reserves for sundry contingencies	221,967 00	874,164 33
Total		$18,140,764.33

(Balance sheet from Bankers' circular offering the notes to the public.)

* In addition to the above liabilities the Company had contracted for $165,000 of machinery which is not included in the assets given above nor in the liabilities.

immediately sold to the bankers for $800,000 and the rest was reserved to refund the entire outstanding debenture bonds of the Turner Company.[1]

The reorganization involved great sacrifices on the part of the old stockholders.[2] The preferred stockholders were given 77% of new common stock for their old preferred stock, — whereas in the tentative plan of December 2, 1912, they were allowed 109% in new second preferred stock. The common stockholders were allowed only $16\frac{1}{3}$% in new common stock, but this allotment was distinctly more favorable considering the value of their security than that proffered the preferred stockholders.[3] It should be remembered that neither the reorganization of 1910 or of 1913 followed an admitted insolvency of any of the subsidiary companies. In the letter to the Loring-Crocker Syndicate Managers, the President of the International Company

[1] The details were approximately as follows: Outstanding Turner Company's debenture bonds $1,482,000, which, through sinking fund operations, would soon be reduced to approximately $1,450,000. A syndicate was formed which guaranteed to effect the exchange of the entire issue of 6 % bonds into 7 % preferred stock. The bonds could be called at par. The syndicate had no difficulty in securing the almost immediate conversion of over $800,000 of the issue. The syndicate was allowed at first a year to accomplish the refunding, but the time was subsequently extended.

[2] The Chairman of the Board of Directors, in his letter to the Deposit Agreement Committee dated April 19, 1913, states: —

"Under the modified plan no Second Preferred Stock will be issued. The Second Preferred Stock originally proposed was to be issued under contract that no dividend (which was limited to 6%) could be paid thereon until after three years. It seemed not unlikely that a dividend would not be paid on the Second Preferred Stock until one was also paid on the Common Stock; furthermore, it was to be redeemable at par; features then not regarded as altogether satisfactory. The market position of a Second Preferred Stock issued under such conditions was doubtful. There will now be two issues of stock only — Preferred and Common. After providing for the above-mentioned comparatively small amount of Preferred Stock, represented by cash, *all the equity* in the property and all net earnings under the modified plan belong to the Common Stock, without limitation as to the *time of payment* or the *rate* of dividends thereon."

The Chairman of the Board was right in stating that the market position of a second preferred stock was doubtful, — yet far less doubtful than that of the common stock of the plan finally adopted. The Chairman of the Board states in the closing paragraph of his same letter, —

"In my negotiations with the bankers, which have extended over the past eight months, my sole object has been to secure for my fellow stockholders — for those I am especially authorized to represent and for myself — the adoption of the best plan possible, consistent with the adequate financing of the business, and to retain for the stockholders the largest equity possible."

[3] The provisions of the reorganization may be found in a printed letter of S. Davies Warfield to the Deposit Agreement Committee, dated April 19, 1913.

prophesied earnings of 7% on the preferred stock and over 10% on the common stock. Especially in 1912, the Company had met with excellent trade conditions so that no vitally different conditions existed in 1913 from those present in 1910 when the Syndicate Managers were soliciting subscriptions to their syndicate; yet now the subscribers were asked to accept voluntarily $93.33 in new common stock in return for their money contribution of $100.[1] On the basis of a valuation of $30 a share for the new common stock[2] the members of the syndicate would be able to liquidate their participation certificates for exactly 28% of the amount they had cost them, — this in the face of no failure of the Company but rather the rehabilitation of its mills and three years of comparative business prosperity.[3] The first preferred stockholders of the old Bay State Cotton Corporation, who exchanged their shares for those of the International Cotton Mills Corporation of New York, were offered, in the reorganization of 1913, $84.70 of new common stock for each of the original shares of Bay State Cotton Corporation[4] stock, — that is a market value of $25.41, for stock originally costing the investors $100.[5] All things considered, the reorganization was particu-

[1] Syndicate subscribers were allotted $100 in preferred and $100 in common stocks of the old International Company of New York for $100 money subscription. The old preferred stock was now given $77 in new common and the old common $16.33 in new common stock of the International Company of Massachusetts.

[2] This was the price offered by the bankers at the time of their sale of the notes.

[3] It is difficult to compare with exactness the results to the syndicate members had the original plan of December 2, 1912, been adopted. Taking $100 in old preferred stock and $100 in old common stock, — representing an original subscription of $100, — the syndicate member would have received $109 in new second preferred and $33.33 in new common stock. All things considered, such a second preferred stock would have probably commanded a market of about $58 a share. The common stock would have been a little less valuable than that created in the final plan, worth perhaps $20 a share. If these figures are approximately correct for purely hypothetical values, the syndicate subscribers would have received securities of about $70 in money value, — against common stock worth $28 in money value as determined in the final plan.

[4] $100 Bay State first preferred = $110 International Cotton (N. Y.) preferred = $84.70 of International Cotton (Mass.) common.

[5] Fortunately no large proportion of the public holders of the first preferred stock had surrendered their shares though the men in control of the Company had. This was particularly unfortunate because it was these men in control of

larly favorable to the bankers' syndicate and to the first mortgage bondholders of the Mount Vernon-Woodberry Company. To both of these classes it was conspicuously more favorable than the plan of December 2, 1912. The bankers' syndicate acquired the notes at a lower price, and its commission in stock was raised from $1,000,000 in a less valuable to $1,200,000 in a more valuable security.[1] It was the sacrifice and penalty the Company was compelled to pay in order to obtain new working capital at a time when market conditions were notably unfavorable. The Mount Vernon bonds were strengthened by a strengthening of the general credit of the holding Company. The Mount Vernon-Woodberry Company in particular was made stronger by the stronger position secured for Turner Company and by the liquidation of a large amount of its floating debt.

Except for the point of view of the old Loring-Crocker syndicate subscribers, the reorganization was eminently wise and conservative. Its weakest point lay in the fact that the Mount Vernon-Woodberry first mortgage bonds remained undisturbed; its strongest point lay in the new capital provided. Ample amounts of money were supplied at a time when working capital was very hard to obtain at any price, and the active support of strong banking interests was secured. The old complexity of intercorporate accounting and financial operations were done away with in a large measure and the Cotton Duck Consolidation emerged with a lower net capitalization and a better organized financial structure than it had ever before possessed.

the Bay State Corporation who had come to the rescue of the old Consolidated Company, when it was on the brink of bankruptcy, and whose efforts had accomplished everything of permanent importance since the reorganization of 1910. The old management of the Consolidated Company had sold out their holdings to the Loring-Crocker syndicates at the critical time, and had shifted the burden to the very shoulders upon which the reorganization of 1913 bore hardest.

[1] The gross profit to the bankers' syndicate was as follows: the notes were sold to the public at 98½ % with bonus of one share of stock or 95½ % without the stock. The gross profits, therefore, on the notes amounted to approximately $220,000. Counting the stock as worth $30 a share, at which Lee, Higginson & Company valued it for their customers, the $1,200,000 of stock had a value of $360,000. The gross money profit amounted approximately to $580,000 in money value out of which, of course, the bankers' syndicate had to meet their own expenses and the expenses of selling the notes to the public.

The financial readjustments of the entire reorganization may be seen from the table on the next page.

Aside from the financial adjustments accomplished by the reorganization, most important changes were effected in the management. The strong technical support brought to the old International Cotton Mills Corporation of New York by Mr. P. T. Jackson, Jr., and his associates was further reinforced by placing much of the direct management in the hands of a firm of mill engineers [1] of successful experience in the management of New England textile enterprises.[2] Through their efforts the loose consolidation of mills developed into a compact unit, in which improvements of technical management became foremost.

Yet the long period of financial readjustment was by no means over. In January, 1914, it appeared that the Mount Vernon-Woodberry group of mills was not earning enough to pay the interest on its bonds. The management therefore very wisely gave notice that the March, 1914, interest would not be paid, and in due course of time the trustee of the bondholders took possession of the Mount Vernon-Woodberry mills and operated them independently of the International Company's. In order to secure the necessary new working capital the trustee of the bondholders

[1] Lockwood, Greene and Company.

[2] It is interesting to note the shift of control of the consolidation from Baltimore to New England. The Mount Vernon-Woodberry Cotton Duck Company was entirely a Baltimore enterprise; with the formation of the United States Corporation the influence of New England appeared. In the International Cotton Mills Corporation of New York the influence of New England men became dominant on the technical side, and with the formation of the International Cotton Mills of Massachusetts the consolidation passed into the absolute control of New England interests. The summary of the various boards of directors shows this objectively.

	Mount Vernon-Woodberry Cotton Duck Company 1899	United States Cotton Duck Corporation 1903	Consolidated Cotton Duck Company 1906	International Cotton Mills Corporation (N.Y.) 1910	International Cotton Mills (Mass.) 1913
Baltimore	13	14	11	4	3
New York	3	6	3	5	2
New England	1	3	1	7	8

obtained the consent of the court to the issue of "trustee's certificates" which were bought by the Turner Company.[1] These certificates were analogous to receiver's certificates. With this separation the history of the old Mount Vernon-Woodberry Company may be said to have reached its final chapter. The outward lines of disintegration had reached such depth that the great consolidation had begun to fall apart by its own weight.

The history of the Cotton Duck Consolidation divided itself into two periods. There was the long period from 1899 to 1910, during which, with inefficient management and improvident financial administration, the succession of companies sank deeper and deeper into quagmire. There was the comparatively short period, during which a new and abler management sought to rehabilitate the depreciated mills and reorganize the complex financial structure. During its entire history there were four more or less complete reorganizations, two of which were preceded by unsuccessful plans. These four reorganizations were alike in certain distinct characteristics. No one of them followed an admitted failure; no one of them was put through with an assessment on any security holder; and no one involved drastic cutting down of either fixed charges or total issued securities. This is clearly seen from the following figures:

	Fixed Charges	Total Securities
Mount Vernon-Woodberry Cotton Duck Company ...	$350,000	$22,500,000
United States Cotton Duck Corporation	350,000	25,750,000
Unsuccessful Reorganization of the United States Cotton Duck Corporation	589,000	27,675,000
Consolidated Cotton Duck Company	426,750	21,175,000
International Cotton Mills Corporation (N. Y.)	657,870	26,271,000
Unsuccessful Reorganization of the International Cotton Duck Corporation (N. Y.)	748,950	29,677,000
International Cotton Mills (Mass.)	679,000	28,305,000

From this table it appears that the net fixed charges have risen with each reorganization from $350,000 for the original Mount Vernon-Woodberry Company to $679,000, for the last and final International Cotton Mills of Massachusetts. The issued securities remained practically the same, but there was a steady increase of securities bearing fixed charges. This tendency has been the result of the policy of obtaining the new money at each

[1] The Turner Company had at the time unfilled contracts calling for the delivery of the products of the Mount Vernon-Woodberry Mills.

reorganization from outside sources, thus demanding a new first lien security. Had the management procured the new money by assessment on the old security holders, or by refunding old bonds into stock, this gradual increase of fixed charges would have been unnecessary.

The table on the following page summarizes certain significant changes accomplished by each successive reorganization.

The noticeable thing is the gradual increase of actual money investment, as the result of the continual subscription of new money. The first marked discrepancy between the cost of the mills and the volume of securities grew less and less with each successive reorganization until, finally, in the new and final International Cotton Mills of Massachusetts the actual money investment and the capitalization were nearly the same. No less significant, too, were the same general tendencies, when expressed in terms of the spindle capitalization and net cost.

One of the important considerations in a succession of reorganizations such as that presented by the Cotton Duck Consolidation is the burden borne by the various security holders. These reorganizations afford clear illustrations of the sacrifices required of security holders, as no assessments were ever exacted nor were any of the reorganizations the result of a judicial winding up of the corporation. An original security holder had merely to exchange his certificates, as each plan was presented to him, so that the original investment may be traced through each succeeding reorganization, without increase by reason of assessment or diminution by reason of forced liquidation. Such a comparison shows clearly the final results to every class of security holder that has, at one time or another, acquired an interest in the Cotton Duck Consolidation. In detail the comparison shows clearly that, despite the varying fortunes of the consolidation, the holders of the original Mount Vernon-Woodberry first mortgage bonds have suffered least. They have received their interest continuously and had, until recently, securities worth nearly as much today as in 1899, — the price of which has reflected but little the continual misfortune of the Company. The preferred stockholders of the old United States

	Date of Organization	New Money Invested	Total Money Investment (Paid in)	Total Issued Securities (in Hands of Public)	Approximate Market Value of Securities at Consummation of Reorganization	Percentage Total Money Investment to Issued Securities	Percentage Market Value of Securities to Issued Securities	Approximate Number of Spindles	Fixed Charges	Contingent Charges	Net Capitalization Per Spindle	Net Money Investment Per Spindle	Necessary Earnings Per Spindle to Pay Fixed Charges	Necessary Earnings Per Spindle to Pay Fixed and Contingent Charges
Mount Vernon-Woodberry Cotton Duck Company	1899	$11,275,000	$11,275,000	$22,500,000	$13,000,000	50%	58%	$225,000	$350,000	$300,000	$100	$50	$1.55	$2.88
United States Cotton Duck Corporation	1901	2,900,000	14,175,000	25,750,000	14,000,000	59%	55%	315,000	350,000	465,000	81	45	1.11	3.58
Consolidated Cotton Duck Company (With J. Spencer Turner)	1906	800,000[1]	14,975,000	22,775,000	11,300,000	65%	50%	320,000	525,000	345,000	71	47	1.64	2.72
International Cotton Mills Corporation (N. Y.)	1910	4,300,000[2]	19,275,000	26,271,000	14,800,000	74%	57%	350,000	658,000	438,000	75	55	1.88	3.13
International Cotton Mills (Mass.).	1913	6,100,000[3]	25,375,000	28,305,000	18,300,000	90%	65%	350,000	679,000	412,000	81	72	1.94	3.12

[1] J. Spencer Turner subscription and estimates of its net quick assets at the time of acquisition.

[2] Determined as follows: —

Boston Yarn Company — Net Quick Assets	$116,000
Bay State Cotton Corporation — Net Quick Assets	300,000
Fixed Assets (50% of Book)	450,000
Loring-Crocker Subscription	1,700,000
Blair & Co. Notes	2 000,000
	$4,566,000
Less Bay State's First Preferred Outstanding	266,000
	$4,300,000

[3] $8,000,000 less $1,900,000 used to refund the Blair & Co. Notes.

Cotton Duck Company, whose lien was parallel to that of the Mount Vernon-Woodberry first mortgage bonds, suffered conspicuously when they surrendered their first lien on their mills. (Table on next page.) And in general, this illustration points to a general principle, — the holders of a first lien security are in an impregnable position unless the holders of the junior securities permit a receivership of the company or succeed in persuading them to surrender their lien. This same principle is admirably illustrated by the difference of position between those of the Bay State Corporation's first preferred stockholders who exchanged their stock for that of the International Corporation and those who retained their old securities. The former were compelled in the next reorganization to accept a lessened par value in common stock, while the latter class still retained their superior lien on the most valuable, comparatively, of all the mills. The table on the next page shows that the earlier interests, after the first failure of their enterprise, suffered less in the later reorganizations than those who had entered the combination at a later time. Thus the subscribers to the United States Cotton Duck Corporation purchase money syndicate, after undergoing three reorganizations, received finally securities worth $14.98 for each $100 originally subscribed, while the subscribers to the Crocker-Loring syndicate received $28 in money value at the succeeding reorganization for each $100 originally subscribed. When securities become of little market value, by reason of the continual failure of an enterprise, almost any reorganization consummated without assessment or foreclosure will probably improve their value; when securities possess a high value, or represent money recently subscribed, any real or fancied difficulty confronting the company will produce a sudden and violent depreciation of their value.[1]

From the point of view of economic history, the long continued failure of the Cotton Duck Consolidation attests in clear

[1] Witness, for example, the rapid depreciation in the value of the M. Rumley Company's preferred stock in 1913 as a result of difficulty in obtaining adequate working capital; the rapid depreciation of the American Express stock in 1913, as a result of the decisions of the Interstate Commerce Commission.

	Money Cost to Original Owners		Par Value of Original Holdings of \$1,000 Par Value of Stock or \$1,000 in Bonds, in the Various Reorganizations,— Par Value of New Securities Given in Exchange							Market Value of \$1,000 of Orig. Holdings, 1913 (\$30 a Share)
	Date	Amount	United States Cotton Duck Corporation, 1901		Consolidated Cotton Duck Company, 1905		International Cotton Mills Corporation, 1910		Int. Cotton Mills (Mass.) 1913	
			Preferred	Common	Preferred	Common	Preferred	Common	Common	
Mount Vernon-Woodberry Cotton Duck Company:										
First Mortgage Bonds	1899	92%	Undis	turbed	Undis	turbed	Undis	turbed	Undist.	
Income Bonds	1899	60%	Undis	turbed	\$500	\$166.66	\$250	\$333 33	\$254.58	\$76.37
Stock	1900	25%	....	\$666.66	....	266.66	. .	133.33	21.70	6.51
United States Cotton Duck Corporation:										
Preferred Stock	1901	100%	\$1,000	....	1,000	....	500	500	499.33	149.79
Common Stock	1901		...	1,000	....	400.00	. ..	200.00		
International Cotton Mills Corporation (N. Y.)										
Preferred Stock	1910	100%	....	....	....	....	1,000		933.33	280.00
Common Stock	1910		....	....	....	....	....	1,000.00		
Bay State Cotton Corporation:										
First Preferred	1909	100%	....	....	....	....	1,100	....	847.00	254.00
Second Preferred	....	....	....	....	....	....	1,000	....	770.00	231.00
Common Stock	....	....	....	....	....	....	....	900.00	110.00	33.00

language to the extreme — perhaps unsurmountable — difficulty of obtaining a man with skill of management sufficient to manage a large and scattered group of mills as efficiently and as economically as the man of ordinary ability can manage a single mill. The success of the small competitors during the period of the consolidated company's failure testified that the theoretical economies of large-scale production may be easily overbalanced by the purely human element of inefficient business ability.

CHAPTER XV

The Promotion of the Asphalt Consolidation

Early history of the asphalt business, 413; the Barber Asphalt Paving Company, 414; the organization of the asphalt supply companies, 415; the London promotion, 418; the Alcatraz group of companies, 419; competitive conditions of the asphalt business in 1899, 420; incorporation of Asphalt Company of America, 421; details of the acquisition of the subsidiary companies, 423; the Warren-Scharf Company, 426; The United Asphalt Company and direct promoters' profits, 428; profits in the promotion of the Asphalt Company of America, 429; the Alcatraz group of companies, 430; the value of the property acquired by the Asphalt Company of America, 432; early history of the Asphalt Company of America, 435; competition by National Asphalt Company, 437; absorption by the National Asphalt Company, 440.

Chronological Summary

1874. First asphalt pavement laid in America.
1876. Formation of first asphalt paving company by De Smedt and Averell.
1878. Barber's first partnership.
1883. Formation of the Barber Asphalt Paving Company.
1884. Formation of the Warren-Scharf Asphalt Paving Company.
1885. Formation of the New York and Bermudez Company.
1896. Beginning of the Alcatraz Company.
1897. Incorporation of the New Trinidad Lake Asphalt Company, Limited.
1899. Incorporation of Asphalt Company of America.
1900. Formation of National Asphalt Company and absorption of Asphalt Company of America.

The formation of the Asphalt Combination was an attempt to secure an absolute monopoly. Its organizers believed that they could control the raw material through the ownership of all the known sources of supply; they believed that they could control the sale of the finished product through their prestige and the specifications in municipal paving contracts. From the very beginning those in control of the business had striven to acquire or control all the available supplies of crude asphaltum and had been largely successful as the known sources of supply were few. In addition they had sought to so control the specifications on city paving contracts that, even when a contract was

awarded a competing paving company, the competitor would be obliged to purchase asphalt of them. When they sought to make their monopoly the more secure through a succession of industrial consolidations, — till the asphalt companies were gathered into a few units, and these into one gigantic holding company,— the monopoly of raw material and finished product, of producer and seller, could not be maintained. New competition appeared at every point, dissension arose in the management of the Consolidated Company. In an instant almost, the whole edifice toppled over by its very weight, exposing roots of exaggeration, disorganization, intrigue, and corporate excesses.

The use of asphalt depends on a highly important technical process for the paving of streets, whereby asphaltum, a refined bitumen, is used as a cement to bind together the mineral aggregate of a roadway, consisting of sand or crushed stones. The resulting asphalt pavement is smooth, hard, durable, not easily affected by extremes of temperature, and one of the few forms of pavement capable of enduring the suction of automobile tires. The asphalt business of this country owes its origin to the experiments of a Belgian chemist by the name of Edward J. De Smedt.[1] He had analyzed the rock asphalt pavings used in Paris in the late sixties before he emigrated to New York in 1870. He supervised the laying of some samples of asphalt pavement in Newark and New York during the period from 1871 to 1873. In 1874, he induced Gen. William W. Averell to form a company for the exploitation of asphalt. A small piece of pavement was laid in Philadelphia in 1874, and a considerable section of Pennsylvania Avenue, between Sixth and Fifteenth Streets, Washington, D.C., was laid in 1876, by the American Asphalt Paving Company, of which Gen. Averell was President. In this case, the selection of asphalt was made by a commission of eminent civil engineers appointed by Congress, and the new kind of

[1] For early papers on the application of asphalt to paving, see Arthur Beckwith, *Report* (1867), United States Commissioners to the Paris University Exposition. See also Article in 106 *Am. Journal of Science*, 409 (1873). Also *Roads, Streets, and Pavements*, by Gen. Q. A. Gilmore. For brief but comprehensive study, together with bibliography, see Day, D. T., "Production of Asphalt in 1912," *U. S. G. S.* 1913. Also Richardson, *Pop. Sci. Monthly*, July, Aug., 1912; Gudger, XXXIV *Science*, 632.

pavement caused considerable comment. The Averell Company was not managed well, however, and De Smedt was not paid his salary. He left it and induced John S. Baldwin to furnish him with capital. Baldwin turned to Amzi L. Barber who, thereafter, became the central figure in the asphalt business of the United States.

Amzi Lorenzo Barber was born in a small Vermont town in 1843, but grew up in Ohio, whither his parents moved when he was very young. After working his way through Oberlin College, Barber taught science in Howard University. He also studied law and was admitted to practise in the Courts of the District of Columbia. Subsequently, he engaged in real estate speculations in Washington with Senator John Sherman, and profited greatly through the expansion of values there. In 1878, he entered into a partnership, known as "John S. Baldwin," for the exploitation of the De Smedt method of laying asphalt pavement. The partnership was later known as "A. L. Barber." The business was directly managed by Barber himself until 1883, when the assets of the partnership, accumulated entirely out of the profits of the business, had amounted to $160,000. In that year the Barber Asphalt Paving Company was incorporated to take over the partnership. Its capitalization was $320,000, half actual property and half good-will. Barber held a three-eights interest in the Corporation and served as its first President. The large working capital required was furnished by the sale of notes issued or endorsed by the partners and later the directors of the Corporation, and this method of financing was continued until the credit of the corporation had attained a very high standing.[1] The profits of the business were very large, and by 1888, the net assets of the Barber Asphalt Paving Company had increased to $750,000, accumulated almost entirely from profits. In 1888, the capital was increased to $1,250,000 by the subscrip-

[1] In the development of the business, Barber had associated with him, J. J. Albright of Buffalo, James Archbold, of Scranton, and E. Burgess Warren of Philadelphia. In 1884, Francis V. Greene (then Captain, recently retired from the office of Engineer Commissioner of the District of Columbia, and subsequently Major-General of Volunteers in the Spanish American War) became Vice-President and in 1893, President of the Company.

tion among the stockholders of $500,000. The early success of the Company was maintained through the depression of the nineties, and by 1899 its capital had increased, from the investment of profits, to $3,900,000, and the surplus account stood at over $200,000. In addition, liberal dividends had been paid throughout the history of the Company.[1]

During the growth of the Barber Asphalt Paving Company, the development of the sources of supply of raw asphalt was pushed by associated interests. In 1876, when the first pavement was laid, a deposit in the Island of Trinidad was the only known source of raw asphalt. This consisted of a solid mass of crude bitumen, about 114 acres in extent, known as a "lake asphalt" of high quality, surrounded by bituminous deposits of inferior grade, known as a "land asphalt."[2] The whole area of the pitch lake was owned by the British Crown, from whom leases had been obtained by various men, who worked more or less in harmony to keep up the price of raw asphalt. The government of Trinidad, however, dug asphalt from a five acre plot in the lake, and for a long time held down the price of the raw material by selling on the open market at competitive prices. The matter was particularly "annoying" to those who wished to maintain a high price, as the viscous substance would flow into the Government pits from the adjoining claims as fast as it was removed. Finally Barber succeeded in securing from the British Crown a concession, dated February 1, 1888, and expiring in 1930, which gave him absolute control of the asphalt lake. By private purchase and lease from the Crown of all asphalt within three miles of the lake, he secured the larger land deposits. The Government concession was obtained by guaranteeing to the Government of the Island $50,000 a year, from a tonnage

[1] For example, a man who contributed $1,000 of new capital in 1888 would have drawn out by 1899 approximately $12,000 through dividend disbursements and the sale of his stock.

[2] The designations of "lake asphalt" and "land asphalt" were arbitrarily made by the Barber interests for the purpose of discrediting the asphalt obtained from the deposits outside of the Pitch Lake. Much of this "land asphalt" was of inferior quality because less uniform in bitumen content and more impure. Some of the impurities were difficult to remove and seriously affected the durability of pavements laid with these asphalts.

royalty on all the asphalt mined and exported. In 1888, Barber organized the Trinidad Asphalt Company, under New Jersey laws, to take over the Trinidad concessions. Its capital was two million dollars, of which $1,825,200 was issued to former leaseholders of portions of the pitch lake in return for the surrender of their leases, and for the purchase of land surrounding the lake. This gave Barber control of the Trinidad supply of "lake asphalt" but a considerable number of the surrounding land deposits were not acquired. As soon as the Trinidad Asphalt Company was in control of the situation and able to raise the price of raw asphalt, the importations from these other land deposits increased from 7,600 tons in 1888, to 20,500 tons in 1891 [1] and Barber entered upon a policy of conciliation and suppression of competition.[2] Control of one competitor after

[1] 1906 G. A. Co. Rep. 7. The importation of "land asphalt" into the United States, which became so important in 1890, was largely in the hands of Carter, Hawley & Co, a tea importing house, which organized the Standard Asphalt Company, and George Christall, who had sugar plantations in Trinidad and shipping interests between Trinidad and New York.

[2] The following statement of the Barber policy was stated in the Third Annual Report of the General Asphalt Company, signed by John M. Mack, President.

"In 1892, a deal was made with the then largest importer of land asphalt, whereby that company, in consideration of receiving a contract for lake asphalt on favorable terms, abandoned the importation and use of land asphalt. The importations of land asphalt thereupon suddenly dropped from 20,500 tons in 1891 to 3,700 tons in 1893. The deal terminated by the purchase of this competitor in 1895, a circumstance which seemed to stimulate the activities of other land asphalt producers, who in 1896 shipped 12,000 tons to the United States. During these years much other competition had been removed by purchase, or by the grant of exclusive territory for lake asphalt in consideration of their abandonment of the use of land asphalt. In this way, not only was the Company gradually reducing its own field of operations, but it was constantly increasing its capital obligations, until at the end of the year 1898, The Barber Asphalt Paving Company, whose capital stock had been increased to $3,913,400, had $1,787,000 invested in stocks of other asphalt companies, many of which were of little or no value." 1906 G. A. Co. Rep. 7-8.

This statement appears to the writer somewhat extreme. It should be accepted with the understanding that in 1906, when the Report was written, the officers of the General Asphalt Company were in the midst of a bitter controversy with Barber. As far as can be gathered from outside sources the "buying competition" was not of great importance, because the competitive paving companies in the United States preferred to use the higher grade "lake asphalt" which the Barber interests were always willing to sell to competitive paving companies. These

another was acquired with money furnished by the Trinidad and the Barber Companies.

In the midst of these efforts to control what appeared to be the only available source of asphalt, competition arose from a new quarter. In 1885, an entirely different company, the New York and Bermudez Company, acquired from an American, Horatio R. Hamilton, a concession granted to him by the Venezuelan Government "to exploit the asphalt in said State of Bermudez."[1] This represented a claim to the famous asphalt lake, located near Guanoco in eastern Venezuela, just across from Trinidad. This claim was further reinforced in 1888 by a mining title granted directly to the Company by the Venezuelan government. Through the activity of Thomas H. Thomas, and A. H. Carner, who with the associates of the former practically owned the New York and Bermudez Company, shipments of asphalt to New York were begun in 1891. Certain paving contracts in Detroit were drawn to allow the use of Bermudez, instead of Trinidad asphalt. At the same time, Thomas introduced a Philadelphia city contractor, John M. Mack, to the asphalt business, and together they secured some Philadelphia contracts. By 1894, the competition of the Bermudez Company was proving strong, but it was crippled by the prevailing tightness of the money market.

paving companies Barber sought to conciliate rather than antagonize, as is shown by an incident that occurred about 1892. A competing company had obtained contracts in a western city at a very low price calling for "Trinidad Lake Asphalt or its equal" and had laid pavements with "land asphalt" purchased from a competitor. The pavements were defective and the company realized that thereafter it must use Trinidad Lake asphalt, the supply of which was absolutely controlled by Barber. In the predicament the officers of the company sought Barber who sold them the "lake asphalt" at a reduced price, so that they would not be ruined by their contracts, on the condition that they use the "lake asphalt" on all future work.

There is probably some truth in the allegation that political collusion was used to insure the adoption of "Trinidad Lake" asphalt to the exclusion of other asphalts as is stated in the Report quoted above, — "The method pursued to thus artificially maintain prices was to secure the adoption of city specifications excluding all asphalts except Trinidad Lake, a course of action frequently involving collusion with city officials, and prolific of vindictive opposition, litigation, heavy expense, and graft." 1906 G. A. Co. Rep. 7.

[1] Original Hamilton Agreement of September 15, 1883. Art. 2.

At this juncture, Barber acquired, in the interest of the Trinidad Company, 85% of the $1,000,000 capitalization of the New York and Bermudez Company,[1] and assumed its bond issue of $250,000. This gave him absolute control over the two deposits; and paving contracts were changed in some cities, through the help of city officials, so as to permit the use of either Trinidad or Bermudez asphalt.

By 1896, the dominant position of the Barber interests in the asphalt business seemed thus indisputable. They controlled the largest paving company in the country, one enjoying high prestige and high credit, and they owned the only known sources of raw material. Barber next conceived the idea of making the asphalt business world-wide in scope, and selected England as the center from which he would extend the operations of the Barber companies in new directions. The plan involved the promotion, in London, of two large companies, one to control the crude asphalt deposits of Trinidad and Venezuela and to conduct generally a wholesale business, throughout the world, the other company to attend to the contract paving business, extending its activities to the principal cities of Europe and America. In pursuance of this policy, Barber made no less than seven trips to London, as a result of which the New Trinidad Lake Asphalt Company, Limited, was incorporated with a capital stock of £500,000 and a bonded debt of £500,000 6% debentures. The entire issue of stock and £400,000 in bonds was given immediately to Barber in exchange for his options on the stock of the old Trinidad Asphalt Company. He had previously entered into a contract with some London promoters to sell the bonds on the English market. Subsequently the bonds were offered in London, but the sale was not encouraging. At a later time, Barber was accused of not accounting for $537,380 involved in this somewhat complicated transaction.[2] From an

[1] The stock issue of the Trinidad Asphalt Company was increased and its shares given for those of the New York and Bermudez Company. By this acquisition and for other concessions in Trinidad the issued capitalization of the Trinidad Asphalt Company was increased from $1,825,200 to $3,080,200.

[2] 1906 G. A. Co. Rep. 9; Seizure of the Property of the New York and Bermudez Company, p. 36.

examination of the accounts, this does not appear to be the case. It appears, however, that no less than £70,000 was expended in London for underwriting commissions, attorneys' fees and such matters, and that Barber himself received from the proceeds of the bond sale, $26,729.27 to defray his personal expenses.[1] Thus in an issue of $2,000,000 of bonds, over $375,000 was dissipated in the expenses of the English incorporation. No new property was added. The New Trinidad Lake Asphalt Company, Ltd., received exactly the property owned by the old Trinidad Company, with an added burden of the debt. Nothing was done toward developing an English paving company, and the idea of a world-wide asphalt business died away.

The monopoly of raw material, even when established on the basis of the two most important natural deposits, was not permanent. In 1896, William H. Crocker of San Francisco, a man who had inherited wealth from mines and the building of the Central Pacific Railroad, saw fit, largely because of social ambitions which might be indirectly furthered, to furnish the financial resources for two men who wished to develop and exploit California asphalt, made from the distillation of bitumen-impregnated sand. Large works were established at Sisquoc,

[1] Owing to the criticism directed toward Barber and also to illustrate the "expenses" of an English incorporation the accounts of the English promotion are appended. The items are condensed from some accounts embodied in a statement found among Barber's papers.

Total issue of 6% debentures:		£400,000
Underwriting commission 10%	£40,000	
City of London Contract Corp. Ltd. and Henry Bell, Esq.	15,000	
Seward, Guthrie & Steele (attys. New York)	2,183	
Ashurst, Morris, Crisp (attys. London)	1,500	
Expenses of the City of London Contract Corp. Ltd.	1,022	
Accountants, brokers, and miscellaneous expenses	10,295	70,000
Total to the credit of the new company:		£330,000
Reserved in treasury. (A large part of this was subsequently employed to buy from the Barber Asphalt Paving Company certain asphalt properties of doubtful value)	£70,000	
Subscribed for, in cash, by stockholders	40,800	110,800
Total cash received by attorneys for Barber		£219,200
Equivalent to		$1,064,216
Paid by Barber to stockholders of Trinidad Asphalt Company	$1,037,486.73	
Barber's "expenses," premiums on stock, accountants, etc.	26,729.27	$1,064,216

California, upon which a mortgage of $400,000 had been executed. Subsidiary paving companies were incorporated throughout the country. In the short space of eighteen months the Alcatraz Companies, as Crocker's various corporations were known, had acquired a formidable position, and competition of the severest kind resulted between the Barber and Crocker factions.[1] Up to that time it had been the custom of the various paving interests, all more or less allied with the Barber Company, to agree among themselves to a territorial division of the paving contracts. In this way prices were maintained without real competitive bidding. Crocker, in conference, claimed one-fourth of the paving contracts of the United States, as his share of the territorial division. This claim was denied by Barber, who endeavored to persuade the Board of Directors of the Barber Asphalt Paving Company to reduce the price of Bermudez refined asphalt to fifteen dollars a ton.[2] At this price his Company could make a small manufacturer's profit. The net cost of production of the Alcatraz asphalt was then about eighteen dollars a ton.[3] So that, in a competitive battle, the Alcatraz stockholders would be suffering a loss, while those of the Barber Company would be just meeting their expenses.

At this juncture, George W. Elkins, who, with his associate, George D. Widener, had been taken into the Barber Company a few years before, to prevent them from establishing a competing land asphalt business, became imbued with the fever of the industrial consolidation movement. They were prominent in Philadelphia. They had the powerful financial support of William L. Elkins, and P. A. B. Widener. Furthermore, up to that time, the spring of 1899, no large business consolidation had been financed in Philadelphia, and Elkins represented to his fellow directors on the Board of The Barber Asphalt Paving Company, that the small investors in Pennsylvania were waiting an opportu-

[1] One feature which made the competition particularly formidable was the fact that the Crocker interests, backed by the Southern Pacific Railroad, consented to offer asphalt in eastern cities at less than the freight rate from California.

[2] F. O. B. New York.

[3] Crocker had been deceived into the belief that he could produce by distillation a refined asphaltum for seven dollars a ton.

nity to place their savings in some promising industrial enterprise. Both he and Widener promised to use influence in obtaining a wide market for the securities of an asphalt consolidation, if one could be arranged.

There is every reason to believe, in spite of much that was said to the contrary at a later time, that Barber preferred to wage a competitive war with the Alcatraz interests rather than effect a consolidation with them. The consolidation movement, however, was a contagion in the atmosphere, and the plan of amalgamation with the Crocker companies prevailed,[1] both Elkins and Widener being deeply impressed with the wonderful future of the asphalt business as depicted by Greene. There is every reason to believe, too, that Barber advocated a more conservative capitalization than was finally agreed upon. But here again uncritical optimism, reinforced by the widely heralded economies of combination, overweighed the dictates of a saner conservatism.

Crocker had his price. He demanded one-fourth of the bonds of the consolidation in addition to a considerable part of the stock. It was the proportion that he had already demanded in the territorial division of the paving business. The general outlines of the combination were agreed upon early in 1899. In the months that immediately followed Crocker concentrated in his hands most of the stocks of his companies, while at the same time, a syndicate consisting of Barber, Greene and Elkins succeeded in bringing under a few heads most of the interests using Trinidad and Bermudez asphalt. No intimation of the forthcoming combination reached the ears of the general public until the early summer. On June 28, 1899, the Asphalt Company of America was incorporated under the New Jersey laws. The authorized capitalization was $30,000,000, divided

[1] The position of Barber was supported by only two other Directors of the Barber Asphalt Paving Company, J. J. Albright and Edmund Hayes. These two men predicted the failure of the combination and would not allow their names to be connected with the consolidated company. The three Directors controlled together hardly a third of the stock of the Barber Asphalt Paving Company and were unwilling to push their advocacy of the policy of competition against the will of the other Directors.

into 600,000 shares, all of one class, with a par value of $50 each. On this stock, $5 a share was paid in at the time of subscription and the certificate of incorporation made the subscribers liable for the remaining 90% of the par value.[1] All but two hundred shares were subscribed for by two of the seven dummy incorporators. The other five incorporators, holding each only forty shares, became the original directors. They retained their positions until December 8, 1899 and January 5, 1900, when the real directors assumed control, — E. Burgess Warren, George D. Widener, and George W. Elkins, to represent the Barber interests; and William H. Crocker, and William J. Latta from the Alcatraz Companies.[2] On July 15, 1899, while the dummy directors were still in nominal control, the Asphalt Company of America entered into an agreement with the Land, Title and Trust Company, of Philadelphia, for the purchase of the securities of thirteen asphalt companies and the issuance of Collateral Gold Certificates against the deposit of these stocks. The Collateral Certificates bore interest at 5% and were protected by a sinking fund of from $25,000 to $100,000 a year, to be paid over to the trustee by the Asphalt Company, from the earnings of its subsidiaries. Slightly less than $30,000,000 of the Collateral Certificates were issued.

Although the offer of purchase, made by the Asphalt Company of America, through the Land, Title and Trust Company, specifically recognized only thirteen companies; these in their turn, included many smaller concerns. The diversity of corporate interests, however, was only nominal. In reality, there were five large corporations involved in the negotiations and four of

[1] Many details of the promotion are given in Receiver Tatnall's Report as to Promoters' Liability. Land, Title and Trust Co. *v.* Henry Tatnall, etc. Cons. cause in Equity. Circuit Court of U. S. for N. J. Report filed July 6, 1903. Extracts reprinted in *Trusts, Pools, and Corporations*, edited by Wm. Z. Ripley, p. 218. In reading the Receivers' Report, however, it should be remembered that the Receivers, particularly one of them, were prejudiced against the promoters of the combination and particularly against Barber. The facts that they state seem to be substantially correct, although their narrative would have greater historical value had many facts not stated been included.

[2] Report of the Committee of the Collateral Gold Certificates of the Asphalt Company of America. Henry W. Biddle, Chairman, p. 3.

these were controlled by the Barber interests. One, with its affiliated companies, was controlled by the Alcatraz group. The Barber Asphalt Paving Company was the center of the whole combination. Closely allied with it were the three other Barber Companies,— The New Trinidad Lake Asphalt Company, Limited, the supply Company, and two smaller corporations, the Warren-Scharf and the United Asphalt. The center of the Alcatraz group was the Alcatraz Company of West Virginia. Affiliated with it were eight sub-contracting companies. Aside from the rights to subscribe to the shares of the Asphalt Company of America, the Barber interests received approximately $22,500,000 in Collateral Certificates and the Alcatraz interests approximately $7,500,000.[1]

The purpose here is not to discuss in detail the corporations acquired by the Asphalt Company of America. A brief outline

[1] The details of these various transfers, as far as the corporations are concerned, can be seen from the following table. Subsequent tables, giving the transactions of the principal stockholders of the companies, will give a clearer view of the real persons directly concerned in the promotion.

Name of Company	Total Number of Shares	Par Value	Shares Purchased *	Price Paid	Cost in Money	Cost in Certificates
Barber Interests						
Barber Asphalt Paving Co. ...	39,000	$100.00	38,993	$300.00	....	$11,697,900.00
New Trinidad Lake Asphalt Co. .	50,000	48.50	49,550	100.00	....	4,955,000.00
			50	84 88	$4,244.32	
Warren-Scharf Asphalt Paving Co.	9,500	100.00	9,493	240.00	5,618 42	2,278,320.00
United Asphalt Co.	40,000	100.00	39,975	91 808	..	3,670,000 00
Total received by the Barber Interests	....	....	....	.	$9,862.74	$22,601,220.00
Alcatraz Interests						
Alcatraz Co. of W. Virginia	800,000	$5 00	799,900	$6 00	....	$4,799,400.00
Affiliated Companies:						
Atlantic Alcatraz Asphalt Co.	1,000	100 00	995	1,000 00	....	995,000 00
Southern Asphalt Paving Co..	250	100 00	245	1,020 00	. ..	249,900 00
Alcatraz Paving Co.	1,000	50 00	995	500 00	. ..	497,500 00
Alcatraz Asphalt Paving Co. ...	1,000	100 00	995	150 00	. ..	149,250 00
Utica Paving Co.	250	100 00	245	510.21	. .	125,001.45
Denver Paving Co.	35,000	1.00	34,950	5.714	....	199,714.09
Southwestern Alcatraz Asphalt and Construction Co.	2,000	100.00	1,995	64.16	.. .	127,999.20
Alcatraz Construction Co.	1,500	100 00	1,495	104 31	.. .	155,943.45
Total received by Alcatraz Interests	..	.. .	....	....	....	$7,299,708.19
Totals	....	....	....	....	....	$29,900,928.19

* The odd shares, recorded as not purchased, were largely directors' qualifying shares. The *Record* states that 9,483 shares of the Warren-Scharf were acquired. It should have been 9,493.

answers the purpose of the present narrative. Eight men controlled the four Barber Companies, A. L. Barber,[1] E. B. Warren, J. J. Albright, G. W. Elkins, G. D. Widener, F. V. Greene, Edmund Hayes, and C. K. Robinson. The Barber Asphalt Paving Company was the most important company. "It was in control of, or largely interested in, sixteen sub-companies, and was doing business directly and through its sub-companies in various parts of the United States and South America."[2] The capital stock amounted to $3,900,000, all of which, except $500,000 subscribed by the stockholders in 1888, had been accumulated from the profits of the business. There was, in addition, a surplus account of $284,746.90. The Company's financial position was not, on the whole, so strong as these figures indicate, as a part of the Company's capital was represented by the "stocks of other asphalt companies, many of which were of little or no value."[3] It was, however, a very strong Company with a long and enviable dividend record, as is shown by the brief outline of its history given in an earlier paragraph. According to its own statements, its earnings for the three years before the consolidation averaged $400,000.[4] This seems to have been excessive, as the Audit Company subsequently showed that the Company had set aside insufficient reserves for maintaining pavements under guarantee,[5] but even with these reservations,

[1] Barber himself had not so large an investment in the Company as many supposed. At the beginning it amounted to only three-eighths of the stock and later, after Elkins and Widener were taken in, it was as small as three-sixteenths.

[2] Biddle Committee Report, 6.

[3] 1906 G. A. Co. Rep. 8. $1,787,000 so invested.

[4]

1896	$491,519.51
1897	455,025.77
1898	244,665.31

Biddle Committee Report, 6. The poorer showing for 1898 was due to the disastrous results of the competition with the Alcatraz interests.

[5] Reserves set aside to keep asphalt paving in repair, in accordance with the terms of certain contracts with cities. At first the guarantee period was five years, which in New York was extended to fifteen years and in some cities to ten years. Contracts for longer guarantee were made at greatly increased prices. Lately, as the industry has grown more standardized the guarantee period has been considerably less, usually from two to five years.

the earning power of the Company was great. The stock was worth just about its par value; and no farther back than January, 1899, about the time the terms of the consolidation were being discussed by the promoters, 30 shares were sold in Philadelphia for $100 a share.[1] The stock was taken over by the Asphalt Company of America at the rate of $300, par value, of the latter Company's bonds for each share.[2]

The New Trinidad Asphalt Company, Limited, held leases to the asphalt lake, in Trinidad; and, through its stock ownership in the New York and Bermudez Company, it owned the great pitch lake in Venezuela, probably the most valuable natural deposit of asphalt in the world. These assets were undoubtedly of very great value, although, subsequently, the title to the Venezuela lake was subjected to serious and costly litigation. The Company was capitalized at five hundred thousand pounds sterling, and there were debenture bonds outstanding to the amount of four hundred thousand pounds.[3] The ownership of its stock rested with the same men as controlled the Barber Asphalt Paving Company, except that 1,718 shares were held in

[1] Biddle Committee Report, 6.

[2] The following table shows the nominal profits obtained by the eight men in control of the Barber group of companies from the sale of this one company. Most of the data for this and the following computations are taken from Receiver Tatnall's Report.

PROFITS FROM SALE OF BARBER ASPHALT PAVING COMPANY'S STOCK

	Number of Shares	Market Value of Shares	Actual Value of Holdings	Price Paid by Asphalt Company of America	Amount Coll. Certif. Received from Asphalt Co. of America	Nominal Profit in Collateral Certif-icates
A. L. Barber	6,000	$100	$600,000	$300	$1,800,000	$1,200,000
E. Burgess Warren	5,164	100	516,400	300	1,549,200	1,032,800
J. J. Albright	2,613	100	261,300	300	783,900	522,600
G. W. Elkins	1,831	100	183,100	300	549,300	366,200
G. D. Widener	1,091	100	109,100	300	327,300	218,200
F. V. Greene	900	100	90,000	300	270,000	180,000
Edmund Hayes	1,264	100	126,400	300	379,200	252,800
C. K. Robinson	281	100	28,100	300	84,300	56,200
Smaller Interests	19,856	100	1,985,600	300	5,956,800	3,971,200
Totals	39,000	...	$3,900,000	....	$11,700,000	$7,800,000

[3] *Infra*, p. 418.

the treasury of the latter Company. Shortly before the organization of the Asphalt Company of America, the Directors of the Barber Company authorized the sale of this stock at $48.50 a share; and the eight men in control purchased 1,515 of these shares at this price,[1] thus adding considerably to their already heavy holdings. The stock of the New Trinidad Company was turned over to the Asphalt Company of America at $100.[2]

Two other businesses acquired by the Asphalt Company of America should be regarded as "Barber interests" although the previous financial investment of the Directors of the Barber Asphalt Paving Company in them was very slight. The first of these was the Warren-Scharf Asphalt Paving Company, established in 1884 by stockholders of the Warren Chemical and Manufacturing Company,[3] in order to engage in the asphalt paving business, then beginning to assume importance through the labors of De Smedt and Barber.[4] Its original capitalization

[1] Receiver Tatnall's Report, filed July 6, 1903.

[2] The following table indicates profits on this transaction: —

PROFITS FROM SALE OF NEW TRINIDAD ASPHALT LIEN STOCK

	Owned Originally	Number Purchased from Barber Co.	Total Shares Owned	Market or Actual Value	Actual Value of Holdings	Price Paid by Asphalt Co. of America	Amount Collateral Certificates Received from Asphalt Co. of America	Nominal Profit in Collateral Certificates
A. L. Barber	4,394	206	4,600	$48 50	$223,100	$100	$460,000	$236,900
E. Burgess Warren . .	4,849	211	5,060	48.50	245,410	100	506,000	260,590
J. J. Albright	3,050	210	3,260	48.50	158,110	100	326,000	167,890
G. W. Elkins	1,639	211	1,850	48 50	89,725	100	185,000	95,275
G. D. Widener	1,273	207	1,480	48.50	71,780	100	148,000	76,220
F. V. Greene	1,822	178	2,000	48.50	97,000	100	200,000	103,000
Edmund Hayes . .	2,131	209	2,340	48.50	113,490	100	234,000	120,510
C. K. Robinson . . .	997	103	1,100	48.50	53,350	100	110,000	56,650
Smaller Interests . . .	.	.	28,310	48 50	1,373,035	100	2,831,000	1,457,965
Totals	. . . .	. . .	50,000	. . .	$2,425,000	. . . .	$5,000,000	$2,575,000

[3] The Warren Chemical and Manufacturing Company had been established in 1855 for the purpose of refining coal-tar and bituminous products for roofing and similar uses. Latterly, the asphalt paving business of the Warren-Scharf Company assumed the greater importance and the Chemical Company became merely a subsidiary of the Paving Company.

[4] *Supra*, p. 413. That is the Warren-Scharf Company was established the year after the incorporation of the Barber Asphalt Paving Company.

was $60,000 but, largely through the investment of profits in the business, had become $950,000 in 1899.[1] The total net assets of the Company then amounted to $1,200,000. Next to the Barber Company, it was the largest asphalt paving company in the United States, and had agencies in more than a hundred cities in the United States and Canada. Ostensibly a competitor of the Barber Company, it was really in close affiliation, enjoying favorable contracts with the Trinidad Company for the supply of its raw asphalt and not competing for paving contracts in cities where the Barber Company had agencies.[2] The promoters of the Asphalt Company of America realized the necessity of acquiring the Warren-Scharf Company, and accordingly offered its stockholders $3,000,000 in Collateral Certificates, or over $315 a share for their stock. The market value, according to the Biddle Committee Report was $150 [3] a share and the book value was $124. The management of the Warren-Scharf Company were suspicious of the large capitalization of the Asphalt Company of America, and refused to accept its securities. They did, however, after considerable negotiation, consent to transfer the ownership of the Company for $1,740,000. From this amount $250,000 was subtracted later for certain assets not connected with the asphalt business [4] which the stockholders of the Warren-

[1] During the first 10 years no money dividends had been paid the Company's stockholders.

[2] Although there was little or no community of stock interest between the Barber and the Warren-Scharf Companies there was no open competition. "At the time the asphalt paving business was in its infancy, and until 1891, the Warren-Scharf Company and the Barber Asphalt Paving Company were practically the only companies engaged in the business. The managers of these two companies were quick to see that the expense of developing the business and of educating taxpayers and officials in the merits of the then comparatively new pavement were such that an unfriendly policy would doubtless ruin the business at the outset. Consequently shortly after the organization of the Warren-Scharf Company a tacit agreement was made under which the Company which first entered the field and developed business in any city should not be interfered with by the other." Statement by one familiar with the Warren-Scharf Company.

[3] Biddle Committee Report, 15.

[4] The allowance of $250,000 from the Biddle Committee Report. As far as the writer can gather, these assets, not acquired by the Asphalt Company of America, consisted of some real estate for a cement plant and some contracts not pertaining to the asphalt paving business.

Scharf Company retained. To obtain the necessary money with which to purchase the Warren-Scharf Company, Messers Barber, Greene and G. W. Elkins arranged a syndicate which acquired the stock.[1] The syndicate then sold the assets of the Warren Chemical and Manufacturing Company, the subsidiary of the Warren-Scharf Manufacturing Company which was engaged in the preparation of roofing asphaltum products, to the Barrett Manufacturing Company for $50,000 or more.[2] Thus the net cost to the syndicate of the Warren-Scharf Company was approximately $1,440,000. The syndicate transferred the Company to the Asphalt Company of America in exchange for $5,618.42 in money, and $2,278,320 in Collateral Trust Certificates, a price somewhat less than that offered originally to the stockholders of the Warren-Scharf Company. In the transaction the buyers and the sellers were to all intents and purposes the same men, — the managers of the syndicate on the one hand, and the promoters of the Asphalt Company of America on the other hand.[3]

The fourth concern in the Barber group, the United Asphalt Company, was promoted for the single purpose of selling it to

[1] The syndicate was participated in by the same eight men who represented the largest stockholders of the Barber and Trinidad Companies and in addition Wm. L. Elkins and Sydney F. Tyler. Receiver Tatnall's Report, filed July 6, 1903.

[2] The Biddle Committee Report, page 15, states that the syndicate received $240,000 in money from the Barrett Manufacturing Company for the assets of the Warren Chemical Company. From direct and reliable evidence from another source it appears that this was an exaggerated statement and that the actual price received was approximately $50,000. Certain other statements in regard to the Warren-Scharf Company, made in the Biddle Committee Report, do not seem to be reliable.

[3] PROFITS IN WARREN-SCHARF SYNDICATE

	Syndicate Contribution	Apportionment of Collateral Certificates	Nominal Profit in Collateral Certificates
A. L. Barber	$233,175	$334,426	$101,251
E. Burgess Warren	215,325	327,294	111,969
J. J. Albright	115,875	176,130	60,255
G. W. Elkins	250,000	380,000	130,000
G. D. Widener	49,800	75,696	25,896
F. V. Greene	50,550	76,836	26,286
Edmund Hayes	64,950	98,724	33,774
C. K. Robinson	20,325	30,894	10,569
	$1,000,000	$1,500,000	$500,000
Wm. L. Elkins	250,000	380,000	130,000
Sydney F. Tyler	250,000	380,000	130,000

the Asphalt Company of America. Either individually, or on syndicate account, the same three men who arranged the sale of the Warren-Scharf Company bought the entire capital stocks of four small contracting companies. For this they paid in cash \$618,000.[1] They then formed the United Asphalt Company, with a capitalization of \$4,000,000, and took over the assets of the four small companies. These assets were of insignificant value. They were represented chiefly by "land asphalt" interests or concerns organized to exploit "land asphalt" paving contracts. The stock of the United Asphalt Company was then sold by Messrs. Barber, Greene, and Elkins to the Asphalt Company of America for \$3,670,000, in the Collateral Certificates, that is for over five times what the properties had cost the syndicate. The profits to the three promoters amounted on the single transaction to over \$3,000,000 in the Collateral Certificates. This step in the promotion is deserving of more than passing comment. As may have been inferred, Barber, his business associate Greene, and Elkins as banker, were the real motive powers behind the formation of the Asphalt Company of America. As promoters, they thought themselves entitled to a promoter's profit of 10% of the total issue of Collateral Certificates, independent of any indirect promoters' profits made through the transfer of their own securities to the new Company. A promoter's profit of 10% would amount to \$3,000,000, exactly the profit derived from the sale of the United Asphalt Company, after deducting \$52,000 for expenses incident to the incorporation of the Asphalt Company of America.

Correlating the results of our analysis of the four Barber Companies, it appears that the nominal profit to the eight promoters aggregated \$8,497,834[2] in Collateral Certificates of

[1]

For stock of Columbia Construction Company	\$250,000
For stock of Trinidad Bituminous Asphalt Company	150,000
For stock of Standard Asphalt Company	200,000
For stock of Rock Creek Asphalt Company	18,000
Total	\$618,000

[2] The following table summarizes the nominal profits derived from the promotion of the Asphalt Company of America by the eight men who dominated the

the Asphalt Company of America. The first sales of the temporary Certificates, in August, 1899, immediately after the successful promotion of the Company, were in the neighborhood of 90% of this par value. The highest price reached was 97%, and the lowest price 89½%. Considering the 93% of their par value as average price at which the public at first acquired the Certificates during August, 1899, it appears that the profits of the eight men in control of the Barber Companies, expressed in immediate market values, either actual or possible, was in the neighborhood of $8,000,000. As a matter of fact, this was not realized, and had the promoters attempted the sale of any considerable amount of their Certificates, they would have ruined their own market. The promoters sold their Certificates, if they sold them at all, at a later date and in a depressed and falling market.

The center of the Alcatraz group of companies was the Alcatraz Company of West Virginia, the property of which has been described already. Up to the time of promotion of the Asphalt Company of America, William H. Crocker held a bare majority of the stock — 401,320 out of a total of 800,000 shares. Between March 8th and the completion of the purchase of the Alcatraz Companies by the Asphalt Company of Amer-

Barber interests. Special commissions, underwriting managers' profits, and the like are not included, as the writer was able to obtain very little light on these indirect profits.

	Profit from Sale of Barber Company	Profit from Sale of New Trinidad Company	Profit from Sale of Warren-Scharf Company	Profit from Sale of United Asphalt Company	Total Nominal Profit in Collateral Certificates	Profit, Possible Market, Taking Collateral Certificates at 93%
A. L. Barber	$1,200,000	$236,900	$101,251	$1,017,333	$2,555,984	$2,376,600
E. Burgess Warren	1,032,800	260,590	111,969	....	1,405,359	1,306,983
J. J. Albright	522,600	167,890	60,255	....	750,745	698,192
G. W. Elkins	366,200	95,275	130,000	1,017,333	1,608,808	1,496,191
G. D. Widener	218,200	76,220	25,896	....	320,316	297,893
F. V. Greene	180,000	103,000	26,286	1,017,333	1,326,619	1,233,755
Edmund Hayes	252,800	120,510	33,774	....	407,084	378,588
C. V. Robinson	56,200	56,650	10,569	....	123,419	114,779
Total	....	....	....	....	$8,498,334	$7,902,981

ica, Crocker acquired practically the entire outstanding minority interest.[1] The stock was transferred to the holding company for $6 a share. It was previously valued by Crocker at a much lower figure. Henry Tatnall, who tried to find the specific cost of this stock, was unable to obtain definite figures. He states, however, that he "has reason to believe that a substantial profit was made by said Crocker in said transaction."[2] The eight affiliated companies of the Alcatraz group were transferred for the sum of approximately $2,500,000. Prior to their acquisition by the Asphalt Company of America, the stocks were concentrated in the hands of a few men, among whom William H. Crocker held the largest interest. Subsequent developments show that the entire Alcatraz group of companies had little earning capacity. Furthermore, a new method of preparing oil asphaltum from the distillation of heavy California petroleum so reduced the competition price of the raw material that the Alcatraz product could not be placed on the market at a profit.[3] During the first two years of the Asphalt Company of America, these Alcatraz companies, costing over $7,000,000 in Collateral Certificates, and carrying fixed charges of over $350,000 per year, actually did business at an average net loss of over $160,000 a year.[4]

Besides the heavy issues of Collateral Trust Certificates, the promoters of the enterprise reserved for themselves the privilege of receiving certain allotments of the share capital of the Asphalt Company of America. For this privilege they paid nothing. The shares were not "full-paid," so that the Company could call for the payment of the par value at any time, and it was understood that $5 per share, or 10%, should be paid after the new Company had been incorporated. These allotments of stock were distinctly arbitrary. The Barber interests, for which three-fourths of the Trust Certificates had

[1] 398,330 shares. Receiver Tatnall's Report, filed July 6, 1906.

[2] Receiver Tatnall's Report, filed July 6, 1906. Transcript of Record, page 507, line 30.

[3] Biddle Committee Report, 11. Also *infra*, p. 445.

[4] Biddle Committee Report, 14.

been issued, were allowed only " 50% of the par value of the stock deposited by each of us." [1]

The par value of the four Barber Companies taken together was a little over $11,000,000.[2] Their stockholders were assigned, therefore, to take only about $5,500,000 of the stock of the Asphalt Company of America. The Alcatraz Companies were permitted to subscribe to varying proportions of stock, — the Alcatraz Company of West Virginia, 200% of its par value; the Atlantic Alcatraz, an affiliated company, 1,000%. Altogether the Alcatraz interests were assigned approximately $9,000,000 of stock.[3] This, it will be observed, was considerably more than the amount assigned to the Barber group, an interesting fact, when one remembers that the Alcatraz properties had little absolute value, no earning power, and had received only a fourth of the Collateral Trust Certificates. What proportions of these original allotments were actually taken up by the stockholders of the companies entering the consolidation the present writer has been unable to learn. At all events, about half the total stock of $30,000,000 was not directly assigned by the promoters to stockholders of the constituent companies. It was distributed without any definite allotment.

At this point it is well to consider the actual value of the various asphalt properties, and the economic basis upon which some $30,000,000 in bonds and the same amount of stock was issued by the Asphalt Company of America. Although the Barber Asphalt Paving Company had a small funded debt, the tangible assets and the high prestige of the Company warrant us in considering it worth the par value of its stock, — $3,900,000.

[1] Agreement of the purchase and sale of the Barber shares. Passage quoted in Biddle Committee Report, 5.

[2]

Barber	$3,900,000
Trinidad	2,425,000
Warren-Scharf	950,000
United Asphalt	4,000,000
	$11,275,000

[3] $9,143,250. Second Petition of William C. Bullitt. L. T. & T. Co. v. Tatnall, etc. Record, 130.

The natural deposits of the Trinidad Company were undoubtedly of great value even though competing asphalts were being constantly pressed upon the market. As an organized business engaged in selling its products in competition with other asphalts the Trinidad Company was worth something less than $4,000,000. It was burdened by nearly $2,000,000 debt. The value of its stock was not over $2,000,000. The Warren-Scharf Company, on the basis of its earning power and the market value of its stock, was worth at most $1,500,000, and the unimportant assets of the United Asphalt Company could not be considered worth more than $500,000 by any reasonable appraisal. At the time, the various Alcatraz companies were acquired, they represented, probably, a legitimate investment of between $1,000,000 and $1,500,000 aside from the mortgage on the California property. Besides the securities of these various companies, the Asphalt Company of America possessed $3,000,000 in money paid into its treasury, as the first subscription by its stockholders. If we estimate the total value of the assets acquired by the Asphalt Company of America as approximately $12,000,000, we are liberal.

The basis upon which was issued nearly $60,000,000 in par value of securities, half in bonds, was not actual value but rather prospective earning power. In the earlier days of the paving business, the gross profits were enormous. This is clearly shown by the fact that the Barber Companies were almost entirely built up out of earnings. Through the disastrous results of competition, the profits had been driven down so that at the time of the promotion of the holding Company, the net profit on the paving branch of the industry was relatively small. In figures it amounted to approximately 50 cents a square yard.[1] The various paving companies were laying, at that time, about 3,000,000 square yards a year, so that, even though the consolidation should obtain no economies and secure no higher prices, it appeared to the promoters that the paving profits alone would equal the fixed annual charges of $1,500,000 on the bonds. In addition the supply companies were making a liberal

[1] Provided the maintenance during the life of the guarantee proved not too burdensome.

profit on the sale of refined asphaltum, which was estimated at the time as $750,000. Most of all, the promoters had implicit faith in the enterprise. Barber believed heart and soul in the business he was engaged in. He was a man of unbounded optimism, who found it difficult to face the possibility of defeat. More than any other man, he had built up the asphalt industry of the country, and he saw no limits to its expansion. Although more conservative than Elkins in financial matters, and less confident in the power of monopoly than Greene, no doubts seem to have entered his mind that the Asphalt Company of America would fail to earn the fixed charges on its $30,000,000 of bonds. In the matter of temperament and point of view, Barber resembled George Westinghouse. Both men had a confidence in their respective businesses, such that they were blinded to the uncertainties of human nature, and the fortuitous influences of unforeseen events.

As soon as the Company had been organized, a call was issued by the Directors for 10% of the par value of the stock, or $5 a share, as had been arranged previously. In the meantime, the enterprise met with such enthusiastic welcome from the public, that the stock of the Asphalt Company of America, with only $5 paid, rose steadily [1] to $17 or $18 a share. When a market had been made for the Company's securities, the promoters sold some of their stock, and with the difference between $5,— the subscription payment to the Company's treasury, — and $14 to $17, — the figure at which it was acquired by the public, — they paid the subscription price of $5 for the stock they themselves continued to hold.[2] The first subscription of $5 a share placed the Asphalt Company of America in possession of $3,000,000 in money. The Company used half of

[1] The rights to subscribe to the stock sold freely at first for $1 a share and latterly at $2.50 a share. First published sales were of August 4, 1899, on the Philadelphia Stock Exchange ($5 paid), 13⅞ to 14. (Par, $50.) The quotations rose steadily, and the sales were cleverly manipulated. This part of the promotion seems to have been under the guidance of George W. Elkins.

[2] By the end of 1900, the men in direct control had divested themselves, apparently, of all the stock except 160,444 shares, $8,022,200. Receiver's Tatnall's affidavit to Court, January 26, 1903.

this money to acquire the entire assets of eleven small contracting companies at exorbitant prices. These were bought first by certain interested parties, and then sold to the holding Company. F. V. Greene, one of the promoters, already referred to as an important member of the Barber group, acquired four of these eleven companies from persons in Omaha, Nebraska, Newark, New Jersey, and in California.[1] This heavy expenditure of working capital, made doubtless in the hope of eliminating all competitors from the field, seems to have been ill-advised. At least, these contracting companies, after they had been brought together as the Consolidated Paving Company, "produced nothing in the way of profits and entailed a loss, — to the Asphalt Company of America, — for the two years from 1900 to 1901, of $45,682.30."[2] "Apparently the Asphalt Company of America aimed at removing all competitors from the field almost regardless of cost."[3]

At the time of the Company's promotion, estimates were made concerning its control over the business of the country. One estimate stated that the new Company would control 95% of the crude asphalt imported and produced in the United States for paving purposes, and would lay 75% of the paving.[4] It is probably fair to assume that the Asphalt Company of America was directly or indirectly in control of about 80% of the asphalt pavement being laid in the United States in 1899.

Leaving now the details of the promotion of the Asphalt Company of America, we may consider its fortunes as a business enterprise. During 1899, the accounting methods employed by the Barber Asphalt Paving Company showed that the Company had received a nominal profit of $474,600.98.[5] Of this

[1] Biddle Committee Report, 20. [2] *Ibid.*, 20.

[3] *Ibid.*, 21.

[4] Total probable amount of asphalt paving to be laid, 4,000,000 square yards. The Asphalt Company of America would lay 3,000,000 square yards.

[5]

1896	$491,519.51
1897	455,025.77
1898	244,665.31
1899	474,600.98

Biddle Committee Report, 6.

amount, $292,447.50[1] was actually paid into the treasury of the Asphalt Company of America. The accountants of the Audit Company of New York, which later examined the books of all the subsidiary companies, estimated the actual profits to be only $35,715.38 instead of $474,600.98.[2] The discrepancy was due largely to under-estimating the cost of maintaining pavements under guarantee. Nevertheless, whatever theory of reserves one accepts, the Barber Asphalt Paving Company was the only subsidiary of the entire group of concerns whose operations resulted in a net profit. Even the nominal profits on the business of this Company fell far short of the fixed charges on those Collateral Certificates originally issued to acquire it. These facts, however, were not fully understood. The report published by the holding Company for the six months ending December 31, 1899 showed earnings of over $800,000, and a surplus earned on the common stock of over $30,000.[3] By all the evidence of outward signs, the Asphalt Company of America was a financial success. That the earnings on the common stock were no more liberal could be attributed to the fact that the first half year was occupied principally in completing contracts deemed unprofitable because taken under highly competitive conditions. It was with some surprise, therefore, that the stockholders learned that the Directors had called for a second subscription of $5 a share, to be paid early in 1900. At the time of incorporation, the stockholders paid $5 a share "just to provide

[1] This and many of the subsequent figures are on the authority of the Audit Company of New York. Report to the Biddle Committee, July 18, 1902.

[2] Biddle Committee Report, 7.

[3]

Dividends on stocks	$792,333.50
Interest received	26,783.09
	$819,116.59
Less organization expense	39,097.34
	$780,019.25
Less 6 mos. interest on Coll. Tr. Certificates	750,000.00
Net surplus	$ 30,019.25

a deposit of $3,000,000 with the Land, Title and Trust Company as additional security for the payment of interest on the $30,000,000 bond issue." Assurances were given, according to reliable report, that no further call would be made on the stockholders, as the Company would need no more money.

In addition to these unprofitable contracts, inherited from its predecessors just referred to, the Asphalt Company of America was confronted from the very first by conditions of severe competition. Among the persons originally interested in the New York and Bermudez Asphalt Company had been a Philadelphia politician and municipal contractor by the name of John M. Mack. In addition to his other affairs, he had built up a local asphalt paving business in Philadelphia, Pittsburg, and Reading. The New York and Bermudez Company had entered into a contract to supply him with asphalt, and he was on friendly terms with the Barber interests. When the Asphalt Company of America was promoted Mack wished to have his paving company taken into the consolidation. He asked the promoters $4,000,000 for it, a price having been determined by means of capitalizing the profits he was then making. He was refused. Not only did the promoters believe that the price was beyond all reason, but they believed it better to have Mack, with his political influence, a friend on the outside than an active power within the consolidation.

Mack was incensed. He planned to compete energetically, even though his company should be involved in loss. His knowledge of the contracting business made it clear to him that, although he might not receive many contracts, he could prevent them from going to the subsidiaries of the Asphalt Company of America on a remunerative basis. To carry out the plan, Mack had incorporated in New Jersey, on May 3, 1900, the National Asphalt Company. It was his intention to include many of the smaller competitors in it, and to gradually extend its influence throughout the Union. To make the position of his Company the more secure, he began to use Mexican asphalt, so as to throw off his dependence on the Barber interests for raw material. The influence of the new Company was felt immediately.

The contract prices of paving did not rise, yet the consolidation was staggering under the load of $1,500,000 in annual fixed charges. It was clear that peace must be made with Mack. It was especially clear to Elkins and Widener, who bore unpleasant recollections of Mack's power in Philadelphia politics and in the local traction situation. To this end a meeting of Barber, Elkins, Greene, and Mack was arranged in the office of Charles R. Flint. After some discussion as to the means of eliminating competition, Greene and Elkins conceived of an entirely new plan, not previously discussed. Greene proposed that the National Asphalt Company should take over the Asphalt Company of America, after issuing its own time notes to fund the total assessment of $6,000,000 already paid on the latter's stock. As soon as proposed Mack accepted the plan without discussion. He was not presented with any financial statements, nor was he told whether or not the Asphalt Company of America was proving a financial success. On August 15, 1900, the charter of the National Asphalt Company was amended so as to admit of the consolidation.[1] On August 29th, the five dummy directors of the National Asphalt Company withdrew; and Messrs. Barber, Mack, Andrews, Sewall, and R. J. Wortendyke, an attorney, took their places.[2] At the same time, Mr. Barber assumed the Presidency of the National Company. Under date of September 13th, a circular was sent to the stockholders of the Asphalt Company of America, signed by Barber as President of the National Company, in which the National Company offered to acquire the stock of the older Company and assume its obligations.

It may well be asked, at this point, why the younger, weaker Company was allowed to absorb the older Company with its larger book assets. Three reasons were more or less important in deciding this feature of the consolidation. First, and perhaps of greatest significance, was the ambition of Mr. Mack. He desired to see his Company the dominant one; as the National Asphalt Company would, as soon as it took over the Asphalt Company of America, control over 75% of the asphalt business

[1] Biddle Committee Report, 22. [2] *Ibid.*

of the country.[1] From the evidence of those who were familiar with the negotiations it seems to be clear that Mack desired to be considered a "Captain of Industry." Apparently here was his chance, which he accepted on the impulse of the moment, without investigation or reflection. Again, should the National Company take over the funded obligations of the older Company, and expressly guarantee the payment of their interest and principal, the standing of these obligations would be somewhat improved. A guaranteed security will always command a higher market price than the same bond or stock without the additional assurance, even though the guarantor is conspicuously weaker than the Company issuing the security.[2] This may seem unsubstantial and sentimental, but it has been a factor in all corporate combinations where consolidation is resorted to in defence of weakness.[3] Another reason involved the question of stockholders' liability. The stock of the Asphalt Company of America was assessable up to its par value. At the time of its issue, it was clearly understood that an assessment of 10%, or $5 a share, should be immediately called, as was the case; but the optimism of the promoters blinded them to the possibility of a further assessment. When, however, a second call of $5 had actually been made, on May 20, 1900, payable June 14, 1900, the holders of the stock had been brought to an abrupt realization of the further legal liability of $40 a share. The liability would be effaced if the stock were to be exchanged for the "full paid, non-assessable" securities of another company. The acquisition of the stock of the Asphalt Company of America by the National Asphalt Company accomplished this desirable end.[4] This matter was especially significant, as 1,718 persons

[1] "The National Asphalt Company, through its subordinate companies, handled probably 85 or 90% of the asphalt sold in the U. S." Affidavit of Sewell, XIII *R. I. C.* 677.

[2] New England Cotton Yarn Company, *supra*, p. 329.

[3] More especially in the field of lighting and traction companies.

[4] In his summary statements, in connection with reprinted extracts of Receiver Tatnall's Report, Professor William Z. Ripley seems to regard this motive as the most important in determining the assumption of the Asphalt Company of America's stock by the National Company. (*Trusts, Pools, and Corporations*, p. 229.) Although perhaps prominently in the background, the present writer is convinced

holding the Collateral Certificates, out of a total of 1,976, held no stock in the Company. The remaining 258 persons, holding less than a majority of the par value of the Trust Certificates, held a liberal working majority of the stock.[1] Receiver Tatnall summarizes this anomalous condition in an affidavit to the court, — "More than six-sevenths in number of the holders of the Collateral Gold Certificates of the Asphalt Company of America, who deposited their bonds under the plan of reorganization, and more than a majority of said deposited certificates, had no connection with the Asphalt Company of America as stockholders of record, at the time of the transfer of certain shares of its stock to the National Asphalt Company, in 1900."[2] In other words, the bondholders of the Asphalt Company of America and its stockholders were groups of different persons; and, in case of failure, the liability on the part of the stockholders for $40 a share would represent a substantial asset of the Company, enforceable by its bondholders.

With these general purposes in view, the capitalization of the National Asphalt Company was so arranged as to allow of the absorption of the older company. It authorized $22,000,000 of "full-paid, non-assessable" stock, and immediately issued the greater part. This amount consisted of $10,000,000 of 6% cumulative preferred stock and $12,000,000 of common stock. The Company also issued $6,000,000 of its own Collateral Gold Certificates to cover the total assessments on the Asphalt Company of America's stock. In the circular of September 13, 1900, the National Company offered to give $10 in its own gold certificates, $7 in its preferred stock, and $10 in its common stock for each share of the Asphalt Company of America's stock, upon which only $10 had been paid.[3] Briefly, the money paid

that the desire of Mack to appear as a "Captain of Industry" was far more important in determining the relative dominance of the two companies. At the time all the parties looked on the failure of the consolidation, once Mack's competition had been eliminated, as a remote possibility.

[1] 366,951 shares out of a total of 598,852. Affidavit of Receiver Tatnall, filed January 30, 1903.

[2] Affidavit of Receiver Tatnall, filed January 30, 1903.

[3] At the time of the conference in Flint's office when the terms of consolidation were arranged, Barber suggested that the preferred and common stocks of the

in on the stock of the old company was preserved as a bonded liability of the new. This offer of exchange on the part of the National Company was immediately accepted by practically all of the outstanding stockholders.[1] "It appears that a majority had agreed to accept before the circular was issued."[2] Of the total amount transferred to the National Asphalt Company, 160,444[3] shares stood in the names of eleven of the Elkins-Barber-Crocker group, the men who might be regarded as the original promoters of the Asphalt Company of America.

Besides the acquisition of the shares of the older combination, the National Asphalt Company also took over the group of small Asphalt Paving Companies which it had been the original intention of Mr. Mack to consolidate into one enterprise. Subsequently, two unimportant contracting companies were acquired. For these various interests, aside from the stock of the Asphalt Company of America, the National Asphalt Company paid nearly $4,000,000, par value, in preferred stock, and $5,500,000 in common stock.[4] The par value of the securities acquired amounted to about $3,500,000, over a half of which consisted of the common stock of the Gilson Company, having little substantial value.[5] The results of the consolidation may be seen from the table given on the next page.

The consummation of this last extension of control in the asphalt industry shows the National Company with a capitalization of $8,000,000 of preferred and $11,500,000 of common stock. Its own debt amounted to $6,000,000, and its assumed debt to over $33,000,000.[6] The Company had, then, a total capitaliza-

National Asphalt Company be divided between the owners of the Asphalt Company of America and the National Asphalt Company. This was done.

[1] 598,852 shares out of 600,000. Affidavit of Receiver Tatnall, filed January 26, 1903.

[2] Words taken from John Douglass Brown, Esq.'s Brief for Appellant, Wm. C. Bullitt. L. T. & T. Co. *v.* H. T., Rec. — U. S. Circuit Court of Appeals for third dist., March, 1904, Nos. 45 and 47, p. 24, l. 27.

[3] Affidavit of Henry Tatnall, Receiver, filed January 26, 1903.

[4] Biddle Committee Report, 29.

[5] See table on page 443.

[6] Counting the bonded debt of the subsidiary companies of the Asphalt Company of America.

ORGANIZATION OF THE NATIONAL ASPHALT COMPANY

	Companies Absorbed			Securities of the National Asphalt Company Outstanding								
	Bonds	Fixed Charges	Stock One Class	Underlying Bonds	National Asphalt Coll. Certificates		Fixed Charges	Preferred Stock		Contingent Charges	Common Stock	
					Single	Aggregate		Single	Aggregate		Single	Aggregate
Asphalt Company of America:												
Underlying Bonds	$3,660,174	$219,610	.. .	$3,660,174	.	....	$219,610					
Collateral Certificates	29,830,755	1,491,538	....	29,830,755	....	....	1,491,538					
Stock (upon which only 20% or $6,000,000 had been paid)	....	....	$30,000,000	....	20%	$6,000,000	300,000	14%	$4,200,000	$252,000	20%	$6,000,000
Other Companies Acquired												
Stocks	....	....	3,447,600	...	...	....	...	.. .	3,799,070	227,944	....	5,550,070
Total	$33,490,929	$1,711,148	$33,447,600	$33,490,929	....	$6,000,000	$2,011,148	.	$7,999,070	$479,944	....	$11,550,070

SUMMARY	Old	New	Change Amount	Change Percentage New to Old
Securities bearing Interest	$33,490,929	$39,490,929	+$6,000,000	119%
Securities bearing Fixed and Contingent Charges	33,490,929	47,490,000	+13,999,070	142%
Total Securities	66,938,529	59,040,070	− 7,898,459	88%
Fixed Charges	1,711,148	2,011,148	+ 300,000	118%
Fixed and Contingent Charges	1,711,148	2,491,092	+ 779,944	146%

tion in the hands of the public of approximately $60,000,000, carrying fixed charges of approximately $2,000,000. The par value of the stock of the Asphalt Company of America was more than that of the securities of the National Company given in exchange, so that it appeared as if the reorganization represented a reduction in capitalization. This reduction was, however, fictitious as $24,000,000 out of $30,000,000 of the stock of the Asphalt Company of America represented mere par value upon which nothing had been paid. The new securities carried increased fixed and contingent charges, so that there was an actual increase in the annual interest and dividend payments of over $750,000. The distribution of securities may be readily seen from the following table.

SECURITIES ACQUIRED AT FORMATION OF NATIONAL ASPHALT COMPANY

	Old Companies		National Asphalt Company Securities given in Exchange		
	Par Value	Old Securities	Bonds	Preferred Stock	Common Stock
Asphalt Company of America Stock (upon which $6,000,coo had been paid)	....	(Approx.) $30,000,000	$6,coc,000	$4,200,000	$6,000,000
Commercial Asphalt Company	$1,000	..	....	....	....
David Folz Asphalt Paving Co.	50,000	....	...	...	....
Gilson Asphalt Company (Pfr.)	269,300	....	....	....	....
Gilson Asphalt Company (Com.)	2,140,300	...	..	....	....
Manhattan Trap Rock Company	500,000	...	...	....	....
Mack Paving Company of N. Y.	10,000	..	.	....	....
N. J. Mexican Asphalt Co.	100,000	....	..	....	....
Pennsylvania Asphalt Paving Co.	250,000	....	...	....	....
Venezuela Asphalt Company	124,000	....	....	...	....
Trinidad Asphalt Company of N. Y.	1,000	....	....	...	....
Trinidad Asphalt Company of N. J.	2,000	....	...	....	....
	$3,447,600	....	....	3,799,070	5,550,070
Temporarily in Treasury	....	....	....	2,000,930	449,930
Total	....	$33,447,600	$6,000,000	$10,000,000	$12,000,000

In addition to the rearrangement of the items of capitalization, there were certain new provisions more or less noteworthy. The Asphalt Companies agreed with the Land, Title and Trust Company, as trustee, to increase the annual payments to the sinking fund of the original Collateral Certificates from $25,000

to $300,000 a year.[1] Furthermore, they agreed to give over to the Land, Title and Trust Company notes and securities of subsidiary Asphalt Companies, amounting to slightly less than $5,000,000, and sufficient money to make the total fund equal $6,000,000.[2] This was equivalent to the two assessments on the stock of the Asphalt Company of America. In case of necessity, part of this fund could be used to pay the interest on the Collateral Certificates, but the agreement required that any amount so used should be replaced within a year. These provisions, it will be noted, were intended to further strengthen the apparent security of the Asphalt Company of America's Collateral Certificates. There was need of this, for the credit of the Company had begun to decline.

[1] Agreement for further security, dated December 31, 1900, article 4.

[2] Agreement for further security, dated December 31, 1900, article 1.

CHAPTER XVI

The Collapse and Reorganization of the Asphalt Consolidations

Competition confronting the National Asphalt Company, 445; controversy in Venezuela, 446; meagre profits of the Asphalt Consolidations, 448; withdrawal of Barber, 451; failure of the National Asphalt Company, 452; the Biddle Committee Report, 456; plan of reorganization, 457; litigation following reorganization, 460; causes of failure of the asphalt consolidations, 461.

Chronological Summary

1901. Decline in value of securities and reports of committees.
1902. Receivership of the two holding companies.
1903. Reorganization and incorporation of General Asphalt Company.

After the National Asphalt Company became supreme in the field its business did not prosper. Competition did not cease. Although the Bermudez and Trinidad deposits were undoubtedly the most valuable in the world, other inferior asphalts found a ready market because of their lower costs. Most serious, however, was the development of a new process for manufacturing a paving asphalt from the heavy California petroleums. This asphalt was not only more cheaply produced than the Alcatraz asphalt, but it could be profitably placed in eastern cities in competition with the South American asphalt of the Trinidad Company. The discovery and profitable exploitation of the California petroleum asphalt put an end, once for all, to the hope the National Asphalt Company had of holding a monopoly in the raw material.[1] To meet this new

[1] The condition has been described by a chemical engineer familiar with the asphalt business; — " As a matter of fact, if it had not been for the development of manufacturing paving asphalt from Californian petroleum, it is probable that the combination would have had a fair chance of success. At the time the combination was formed there was no asphalt on the market manufactured from California petroleum. The only Californian asphalt on the market was that extracted

competition, the Trinidad Company reduced its price for Trinidad and Bermudez Asphalt so low that little profit was realized.

The paving business, too, was unprofitable, largely because of the aggressive bidding on contracts by Messrs. Chas. M. Warner [1] and P. R. Quinlan of Syracuse, New York. Although the former became a stockholder of the Asphalt Company of America subsequently,[2] yet during 1900 and 1901, the Warner-Quinlan interests waged a severe competitive war against the Barber Company, first with the coöperation of Mr. Mack, and later alone. They failed to secure any large percentage of the paving contracts, but prevented the Barber Asphalt Paving Company from obtaining them on a remunerative basis.

Another unexpected handicap that the National Asphalt Company met was the serious and costly litigation over the title to the deposit of raw asphalt in Venezuela. This title had been

by the Alcatraz Company from the asphaltic rock of California and the hard asphalt produced in mining operations. Neither of these asphalts could be placed east of the Rocky Mountains in competition with Trinidad or Bermudez asphalt. When, however, it was found that an excellent paving asphalt could be manufactured from Californian petroleum by distilling off the lighter oils and that such asphalt could be placed in the eastern cities (bitumen contents being taken into account) as cheaply as Trinidad or Bermudez, there was no hope of establishing a monopoly, as production of California petroleum was and is unlimited as far as the asphalt market is concerned. This development of California asphalt could not have been foreseen, for although many endeavors had been made to make a paving asphalt out of eastern and Texas petroleums, they always resulted in failure, although out of these petroleums a so-called asphalt was manufactured which was purchased at a low price by paving contractors and mixed with Trinidad or Bermudez asphalt to bring down the cost."

[1] Charles M. Warner was one of the promoters of the American Malting Company, *supra*, pp. 272 f.; he sold a glucose refinery to the Corn Products Refining Company, p. 104; he was concerned in the formation of the Bay State Cotton Corporation, p. 380, and became subsequently a Director of the International Cotton Mills Corporation, p. 387. He had owned a small contracting company, the Columbia Construction Company, which had been bought out by the United Asphalt Company syndicate at the time the Asphalt Company of America was formed. He was not then told that his Company was being acquired in the interests of an industrial consolidation, and did not ask the relatively high price that would enable him to obtain a profit corresponding to what he had already obtained in selling his malt houses to the American Malting Company, and that he later obtained in the sale of his glucose refinery to the Corn Products Refining Company.

[2] Report of Receiver Tatnall on "Call on Stockholders," filed July 6, 1903.

granted to a subsidiary, the New York and Bermudez Company, in 1883[1] and further strengthened by a mining title granted in 1888. But the Venezuelan government, finding that the business of exploiting was proving profitable, permitted certain favored persons to enter titles to lands and asphalt deposits already granted to the New York and Bermudez Company. One of these fictitious titles was sold to the Warner-Quinlan Company for $40,000.[2] Just before this on October 23, 1899, General Cipiano Castro had, by revolution, become Dictator of Venezuela. He proceeded to protect the new titles to the asphalt deposits by further decrees granting additional railroad and dock concessions. The Asphalt Company of America naturally strove to defend its rights so far as the Venezuelan courts would permit. In the course of the controversy, an agent of Castro offered to "put the thing through exactly as wanted, and in such a way as to insure the Company against any future difficulties in the matter of rights and properties, all for the sum of $400,000." [3] The Company refused to pay the sum, and appealed to the Department of State, at Washington, for relief. Secretary Hay replied, "that the Department does not feel warranted in interfering with the course of judicial proceedings in Venezuela." [4] These judicial proceedings proved very costly, and although, subsequently, while Castro was engaged in a controversy with Germany and Great Britain, his courts rendered a decree in favor of the Company,[5] the expenses during the two years, 1900 and 1901, averaged $220,000 a year.[6] Besides the direct expenses the Company was hampered in getting its supply of raw material, the quarrel sometimes even reaching the stage of a pitched battle

[1] Granted to Horatio H. Hamilton, Sept. 15, 1883, and assigned to the N. Y. & Bermudez Co., in 1885. Concession to exploit the asphalt and woods "in the uncultivated lands of the State of Bermudez."

[2] "La Felicidad" sold May 25, 1900, to Patrick Sullivan, secret agent of Messrs. Chas. M. Warner and Quinlan of Syracuse, N. Y.

[3] Letter of A. H. Carner to the National Asphalt Company, dated December 29, 1900. Quoted in *Seizure of the Property of New York and Bermudez Co.*, 17.

[4] Letter of February 28, 1901, to Nicoll, Anable, and Lindsay. *Ibid.*, 24.

[5] January 28, 1904. Details, *ibid.*, 33.

[6] Biddle Committee Report, 47.

between the employees of the Company and the soldiers of the Government.[1]

These disturbing conditions showed themselves in the earnings of the subsidiary corporations of the Asphalt Company of America. Severe losses were sustained by the two general contracting companies. Neither of these had anything to do with asphalt pavement,[2] and both had been a burden to the Asphalt

[1] Subsequent incidents of this controversy may be of interest, as it threatened at one time to attain international importance. Long prior to the favorable judgment of the Venezuelan court, Barber had left the National Asphalt Company, A H. Carner, the agent in Venezuela, was called to New York early in 1901, and was summarily dismissed. In 1902, Barber and Carner, with the financial help of Franklin Haines formed the Pan-American Asphalt Company as a competitor of the Asphalt Company of America. At first the new Company derived its supply of Asphalt from Mexico. In March, 1904, Carner went to Venezuela, and was told by Castro that the latter had procured evidence which showed that the National Asphalt Company had helped to finance a certain unsuccessful revolution against him, instigated by one Manuel A. Matos. He proposed that his courts should throw the Bermudez Company into the hands of a receiver and that Carner should be appointed. This was done. Meanwhile Barber, in New York, formed the A. L. Barber Asphalt Company to use the Bermudez asphalt furnished by Carner. At the same time he had the paving specifications of the Borough of Manhattan so changed as to contain a note to permit of the use of Venezuela asphalt alone, — the supply of which he himself now controlled through Receiver Carner. The Castro government then brought suit to annul the original concession to the New York and Bermudez Company, on the ground that they had failed to canalize certain rivers. Afterwards, the Government added the charge that the New York and Bermudez Company had furnished the Matos revolutionists with a gun boat, the Ban Righ. The actual payments to Matos amounted to $145,000. Castro demanded of the New York and Bermudez Company a heavy penalty, amounting to something like $5,000,000. Various appeals were made to the Government at Washington, Commissions were sent to Venezuela to investigate, and gunboats to insure a respect for our Government. There were charges and counter charges. Largely as a result of the controversy, Assistant Secretary of State Loomis, and Mr. Bowen, Minister to Venezuela, retired from the diplomatic service. Finally, in 1908, the Castro government was overthrown, and on February 13, 1909, the Bermudez Lake was returned to the New York and Bermudez Company, the latter agreeing to a fine of $60,000. (For particulars, see Senate Document 413, 60th Cong., 1st Sess.; Letter of John W. Foster, April 14, 1908, and Appendix (printed) very full; Taft Letter on the Bowen-Loomis Controversy; 1907 *North. Am. Rev.* 579; also two publications by interested parties, — " Seizure of the Property " etc., by New York and Bermudez Co., and " Castro and the Asphalt Trust " by O. E. Thurber.)

[2] The National Contracting Company, the more important of the two, had been formed in the early history of the Barber Asphalt Paving Company for the purpose

Company of America. During the years from 1899 to 1901, practically every contract undertaken by these two companies resulted in a loss; in the aggregate, these losses averaged upwards of $230,000 a year. The expenses of the litigation in Venezuela, and the direct losses of the contracting companies amounted in two years to the round sum of $900,000.[1] These two items alone equalled almost a third of the interest charges on the Collateral Certificates. The other subsidiary companies were, unfortunately, no more profitable under the National Asphalt Company than they had been under the Asphalt Company of America. It will be remembered that, at the close of 1899, the books of the Asphalt Company of America showed a profit, after charges, of $30,000, whereas subsequent revelations showed a net deficit of $900,000.[2] During 1900, the Barber Paving group made a profit of nearly $250,000, and the supply companies a profit of $150,000. To counterbalance this, the Alcatraz group sustained a loss of $190,000,[3] and the Consolidated Paving Company one of $37,000. Thus, the total earnings of the subsidiaries of the Asphalt Company of America amounted to $225,000, while the interest charges called for the payment of nearly $1,500,000. Hidden away in the books of the subsidiary companies there was an actual deficit of $1,265,700.[4] During the preceding year, the deficit had been $900,000, so that, at the close of 1900, the Asphalt Company of America had sustained a total loss of over $2,000,000.

Meanwhile other matters, more or less personal, were undermining the position of the asphalt consolidation. Before the formation of the Asphalt Company of America, the Barber

of undertaking contracts other than paving, with the idea of keeping the employees of the Barber Company busy during winter months and in cities where the paving plants were idle. It incurred nothing but heavy losses.

[1] Biddle Committee Report, 47.

[2] The figures in this paragraph are deduced from the Biddle Committee Report.

[3] It will be remembered that the Asphalt Company of America paid over $7,000,000 in Collateral Certificates for the Alcatraz companies. The interest on these certificates amounted to over $350,000.

[4] The following tables illustrate the general profit and loss accounts of the subsidiary companies of the Asphalt Company of America during 1900. Figures

Asphalt Paving Company was almost a close corporation. It was a matter of common report that no important motion was carried through the Board of Directors except by the unanimous consent of all the members. The loyalty of each Director to the Company was remarkable, as is shown, for example, by the fact that the high credit of the Company was built up through the personal endorsement of the Company's notes by the Directors themselves. They had been long and closely associated with each other. They were on terms of intimate friendship. When the Barber Company was taken over by the Asphalt Company of America, although the same men retained more or less responsible positions, this personal appeal of the organization was lost. New men, like William H. Crocker, became interested in the Company, and its real ownership was transferred from the Directors themselves and their friends to the general investing public. Elkins proved very successful

are compiled from the reports of the Audit Company of New York to the Biddle Committee. The figures for 1901 are added together with the additional profit and loss statement for the National Asphalt Company for the purpose of comparison.

		1900		1901
Barber Asphalt Paving Company	(Profit)	$245,341.57	(Profit)	$506,358 22
Supply Companies	(Profit)	140,337.42	(Loss)	− 60,460.22
Alcatraz Companies	(Loss)	−190,313.33	(Loss)	− 142,755.03
United Asphalt Company	(Profit)	13,671 25	(Profit)	30,247.84
Net Profits of above Company		$209,036.91		$333,390.81
Subsidiary Income, after Deducting General Expenses and Bad Accounts		16,800.17		156,052.02
Net Earnings from Operation of Asphalt Company of America		225,837 08		489,442.83
Less Interest on Asphalt Company of America Collateral Certificates		1,491,537 72		1,491,537.72
Deficit		1,265,700.64		1,002,094 89
Losses of the Subsidiary Companies of the National Asphalt Company, not included in the Asphalt Company of America. (The year of the Consolidated National Asphalt Company began January 1, 1901)				118,015.57
Net Deficit of National Asphalt Co				1,120,110.46
Interest Charges on the National Asphalt Company Collateral Certificates				300,000.00
Deficit Consolidated Companies				$1,420,110.46

(In the above summary no annual charges to sinking funds were included.)

in making a market for the Company's securities, but this involved a decentralization in real ownership. The making of a market, too, presented temptations. When the Barber-Greene-Elkins syndicates had acquired the subsidiaries of the Warren-Scharf and the United Asphalt Companies they had paid for them in money raised by loans from bankers. When the market for these Certificates was first determined, — from 90% to 97%, — the syndicate managers liquidated a sufficient amount to enable them to pay the loans with the bankers. This liquidation represented the first Certificates presented for sale. Soon, however, a Director from the far west, feeling no particular responsibility toward the Company, much less toward the Philadelphia investing public, began to press his Collateral Certificates on the market. Many of them were absorbed by real investors, who had been inspired with confidence in the enterprise through the connection of Elkins and Widener. The price realized was about 85%. Subsequently other Directors began to sell, and possibly also some of the smaller interests.[1]

Meanwhile Barber, Greene, and Elkins held most of their Collateral Certificates through a constantly falling market. After Mack and the National Asphalt Company had entered the consolidation slight friction arose. Barber felt the old loyalty toward the business slipping away. Mack allowed a personal dislike for Elkins and Greene to find expression.[2] At the same time Barber, with the insight into the business obtained by long experience, saw clearly that the subsidiary companies, still harassed by competition on every side, could not earn a

[1] The smaller interests included minor officials and employees who had an intimate knowledge of the details of the business and sold out their comparatively small holdings as soon as the securities were issued.

[2] According to a confidential statement issued later by Barber, he discovered "that the chief executive officer was marked for dismissal, or, as the phrase was, 'would go over the gang-plank when the first landing was made' that the very men who had caused the existence of the Asphalt Company of America and its merger with the National Asphalt Company were to be the objects of political and business 'hold ups,' as had previously been already done (and shortly after was done again) all of which was communicated to Mr. Barber in strict confidence (from which he now considers himself released." Statement of A. L. Barber, dated Washington, D. C., April 30, 1908.

sufficiently large net profit to enable the Asphalt Company of America to meet the interest charges on its outstanding obligations. Accordingly he sold his Collateral Certificates at various times. On January 3, 1902, three days after the National Company had assumed control of the consolidation, Barber resigned his position as President, and thereafter ceased to concern himself with its affairs. He did this ostensibly to save the Company his salary of $30,000 a year, but in reality, because he had lost his financial and personal interest in the entire enterprise.[1] Thereafter the direction of the Company's affairs rested in the hands of Mack and his own associates. Greene was the only one of the old Barber group who continued in active control. He was Managing Director of the supply company.

As the time approached for the payment of the semi-annual interest of April 1, 1901, there was no money in the treasury of any of the Companies with which to meet it. To maintain the credit of the Company the interest must be paid, and the only means available was to borrow. On March 19th, the Directors of the Asphalt Company of America passed a resolution, authorizing the Land, Title and Trust Company to take $745,-768.86,[2] from the cash in the trust fund of $6,000,000 created at the time of the formation of the National Asphalt Company, as an additional security for the underlying certificates. With this, the Trust Company paid the interest on the Collateral

[1] Barber withdrew and later with certain others formed the Pan-American Company, and later the A. L. Barber Asphalt Company. The connection of this latter Company with the seizure of the Bermudez pitch lake in Venezuela was referred to in the note on page 448. On January 17, 1906, he was instrumental in forming the Independent Asphalt Association, to bring together the independent paving contractors to fight the Barber Asphalt Paving Company. These contractors were chiefly customers of the A. L. Barber Asphalt Company for the Bermudez Asphalt which Barber then controlled through Receiver Carner. Mack is said to have remarked that the Association was Barber's selling agency. It certainly furnished him with an organized outlet for the Bermudez Asphalt. Barber died April 17, 1909. During the latter part of his life he invested heavily in the automobile industry, controlling companies manufacturing the "Stanley Steamer" and the "Locomobile."

[2] Testimony of Albert A. Outerbridge, given March 4, 1903. L. T. & T. Co. v. A. Co. of Am., Consolidated Suit. Record, 323.

Certificates due April 1, 1901. By a similar resolve, they also took from the same fund the interest on the Certificates due October 1, 1901.[1] In a word, the Asphalt Consolidation paid the interest on its securities through extensive borrowings known only to the management and the trustee, while the business of the underlying companies was accumulating a constantly increasing deficit. This misrepresentation was made possible by the intricate intercorporate relations between a holding company and its subsidiaries. The actual state of affairs was unknown to the public and the only suggestion of impending disaster was the rapid decline in the market value of the securities. Such officers as consented to discuss the situation could not account for the decline, and inspired interviews emphasized the troubles in Venezuela and the unsettled conditions of trade. The decline was the more surprising, because the average market price of industrial securities had been rising since the promotion of the Asphalt Company of America.

The officers were, apparently, blind to the real condition of the business, although perhaps not so completely as they subsequently asserted. Mr. Mack and his associate, Mr. Sewall, had risked their own business interests and reputation in the formation of the National Asphalt Company. They held their securities during the collapse and reorganization of the enterprise, and paid the assessment on the stock. As late as September, 1901, Mr. Mack asserted, "I have every reason to believe that the increased volume of the business and the many economies of administration and operation introduced this year will result in a substantial increase over the earnings of 1900, when, as you are aware, the interest on the $30,000,000 Asphalt 5's was earned and paid."[2] He later stated that the truth concerning the Company's affairs "came as a disagreeable surprise"[3]

[1] *Ibid.* The fund in question was largely invested in the notes of the subsidiary asphalt companies. It appears from other evidence that to supply the necessary ready money the Barber Asphalt Paving Company borrowed from banks and made an advance payment on account of its dividends amounting to $560,000. This enabled the Asphalt Company of America to meet the interest due October 1, 1901, on its outstanding Collateral Certificates.

[2] Land, Title and Trust Co. *v.* A. Co. of Am., Record, p. 116, l. 32.

[3] *Philadelphia Public Ledger*, April 1, 1902, quoted in Record, page 117, line 13.

to him soon after this assertion was made. The most that can be said is that Mr. Mack conceived himself a true "Captain of Industry" and came to realize the difficulties of his position only after the hopelessness of the Asphalt consolidation was forced upon him. He asserted that it was "manifestly impossible that I, or anyone, could have carried along the intricacies of a business in which there were sixty-nine subsidiary companies."[1] It had been possible for him to compute on paper, on the basis of the net profit he was accustomed to make and the amount of work under contract by his subsidiary companies, that the business was earning its fixed charges. Moreover, he had not had a long familiarity with all the phases of the asphalt business, and probably failed to give important details the attention necessary to form a correct estimate of the true earnings. General Greene was in a position to understand fully the situation, but he maintained full confidence in the ultimate success of the consolidation, and it appears that he retained his securities through the depression, losing heavily in the reorganization. Mr. Elkins and Mr. Widener were simply financiers. As soon as the combination had been formed, they passed over the active management of its affairs to others. Their names secured a wider investment market for the Company, and gave to the whole combination a standing in Philadelphia which it otherwise could not have possessed. In all other respects, their connection with the actual business of the Company was purely nominal.

During October, 1901, the serious state of the Company's affairs was realized by men close to the management. Rumors of financial unsoundness reached the public, and the market price of the securities of the Asphalt Companies fell rapidly. On November 14th a Committee was formed to represent the Asphalt Company of America's Collateral Gold Certificates, and four days afterward another Committee to represent the securities of the National Asphalt Company. Henry W. Biddle acted as Chairman of the former Committee, and William F. Harrity of the latter. Their preliminary investigation was not

[1] *Philadelphia Public Ledger*, April 1, 1902, quoted in Record, page 117, line 6.

reassuring; and on December 28, 1901, they caused the Land, Title and Trust Company, as trustee for the holders of the funded debt, to file a Bill of Complaint, praying for the appointment of Receivers for both the National and the Asphalt Company of America. The petition was granted by Judge Kirkpatrick of the Circuit Court, who appointed as Receivers, Henry Tatnall, then President of the Franklin National Bank of Philadelphia, John M. Mack, Vice-President of the National Asphalt Company, and John F. Shanley, a sub-contractor.[1]

The failure of the Asphalt Consolidations created almost a public scandal in Philadelphia, where their securities were chiefly held. On the strength of the financial backing given the enterprise by Elkins and Widener, and the generally favorable attitude which most Philadelphia bankers took toward the whole undertaking, large numbers of small investors had been induced to put their savings in the Collateral Certificates of the Asphalt Company of America. As they were issued in hundred dollar pieces, they appealed to the class of savers who had not the money to buy a five hundred or a thousand dollar bond. Furthermore, the investment bankers had, in the years 1900 and 1901, lost all their conservatism regarding industrial enterprises; and, through the bankers, the wild mania of misguided optimism reached the investing public. When the crash came, a very large proportion of the Collateral Certificates were in the hands of people who could not afford to lose their savings, people, moreover, who knew nothing concerning finance, and had relied with implicit confidence on the recommendation of their bankers. Many of these, previously in moderate circumstances, had their incomes entirely stopped by the failure of the Company, and were compelled to take lodgers, or turn to relatives for support. The daily papers of Philadelphia took up the cause of the deceived investor, and did much to focus indignation on all in the least concerned in the promotion of the enterprise. The feeling against these men reached so intense a pitch that their careers

[1] Mr. Shanley was appointed as the resident New Jersey Receiver, as the court required that one of the receivers should be a resident of the state. Later he resigned.

and motives were cited by the papers and the pulpit as typical of the basest dishonesty. Yet they were prompted by no dishonest motives. They had been caught by the insane fever for industrial consolidation in which the public, too, had shared quite as much as they themselves. The investors in buying the overlying securities of an untried industrial enterprise were breaking every canon of sound investment. When the failure came, they cast about for other shoulders to bear the blame for their own impulsive judgement, forgetting that the responsibility of choice was theirs alone.

During this time, the ponderous machinery of the law was bringing order out of the chaos of ruin. Under its direction, Receiver Tatnall was organizing the business into compact form. He liquidated those subsidiary companies which failed to show a profit. He consolidated others. He brought several manufacturing plants under one roof and closed those unfavorably situated. The California property of the Alcatraz Company, for which over $7,000,000 had been paid in Collateral Certificates, was allowed to go for an underlying mortgage of $400,000. In all ways, the Receivers conducted the business with marked wisdom.

The Biddle Committee issued a preliminary report, on March 27, 1902, in which they incorporated the statement of earnings prepared for them by the Audit Company of New York. This statement served to emphasize further the deplorable conditions into which the Company's finances had sunk. On July 18th of the same year, the Committee issued a more exhaustive report, setting forth, at some length, the promotion and financial history of the two Asphalt Consolidations. After a somewhat cursory analysis of the earnings of the companies during the preceding two and a half years, the Committee recommended an immediate reorganization of the Company. The report closed with a letter from Receivers Tatnall and Mack, stating that "We believe it reasonably safe in making up your Plan of Reorganization, to calculate that the net annual earnings will approximately be $700,000." [1] This amount was reached by adding to the average

[1] Biddle Committee Report, 47.

earnings of the Company the losses suffered by the subsidiary contracting companies and a proportion of those incurred in Venezuela. Early in July a plan of reorganization was agreed upon between the Biddle Committee representing a majority of the Asphalt Company of America's Collateral Certificates, the Harrity Committee representing the securities of the National Asphalt Company, and the two Receivers. This plan, later successfully carried out, deserves careful study, because of the radical manner in which all the old securities were treated.

Three points require special mention. Most significant is the fact that all bonded liabilities of the two holding companies were extinguished, the holders of the old Collateral Certificates of the Asphalt Company of America receiving only a half of their bonds in new preferred stock.[1] In this way, all fixed charges were avoided, and the complicated relation between the Asphalt Companies and the Land, Title and Trust Company, as Trustee, became a thing of the past. Further, the Directors were forbidden to incur a floating debt in excess of a certain amount,[2] without making themselves personally liable for its payment. The second noteworthy feature was the reduction of capitalization. The total capital liability of the Asphalt Companies amounted to upwards of $90,000,000 of which upwards of $60,000,000, were in the hands of the public. This was reduced, in the reorganization, to less than $30,000,000 of stock, and some underlying bonds. Last, but certainly not least for the success of the new company, was the working capital of $2,500,000, for which the plan provided. All the securities, except the Collateral Certificates of the Asphalt Company of America, were assessed.[3] The men behind the reorganization had in view a closely knit, conservatively capitalized company, with no funded and little floating debt, and a liberal sufficiency of working capital.

[1] Details taken from Plan of Reorganization dated July 18, 1902.

[2] 15 % of the outstanding capital stock, approximately $3,600,000. Plan of Reorganization, 3.

[3] This liberal contribution of working capital was made possible by the willingness of Elkins, Widener and their associates to contribute $2,250,000 for the common stock of the new company taken at 50 %. There was little chance that the stock would be worth this, so the relief afforded represented a distinct sacrifice on their part.

REORGANIZATION OF THE ASPHALT CONSOLIDATION

	Old Companies							The General Asphalt Company						
	Bonds	Fixed Charges	Preferred Stock	Contingent Charges	Common Stock	Assessment		Bonds	Fixed Charges	Preferred Stock		Contingent Charges	Common Stock	
						Single	Aggregate			Single	Aggregate		Single	Aggregate
Underlying Bonds[1]	$3,501,020	$210,000	....	....	....	....	....	$3,501,020	$210,000					
Asphalt Co. of America Collateral Certificates	26,932,255	1,346,613	....	....	....	....	....	....	....	50%	$13,466,127	$673,306		
Asphalt Co. of America Collateral Certificates	2,500,000	125,000	....	....	....	....	....	....	....	....	....	....	60%	$1,500,000[2]
National Asphalt Company Collateral Certificates	5,988,520	299,446	....	....	....	1.6 %	$95,816	....	....	....	....	....	40%	2,395,408
National Asphalt Company Preferred Stock	....	....	$8,003,744	$480,225	....	.44%	35,216	....	....	....	....	....	11%	880,412
National Asphalt Company Common Stock	....	....	....	....	$11,551,570	.16%	18,482	....	....	....	....	....	4%	462,062
Elkins-Widener Syndicate Furnishing Working Capital	....	....	....	....	....	....	2,250,000	....	....	....	....	....	....	4,500,000
Adjustment of claim of A. Busch	....	....	....	....	....	....	....	....	....	....	....	. .	....	260,000
Reorganization Purposes	....	....	....	....	....	....	.. .	....	....	....	533,873	26,694	....	2,117
Totals	$38,921,795	$1,981,059	$8,003,744	$480,225	$11,551,570	.. .	$2,399,514	$3,501,020	$210,000	. ..	$14,000,000	$700,000	....	$10,000,000

SUMMARY	Old	New	Change Amount	Change Percentage New to Old
Securities bearing Interest	$38,921,795	$3,501,020	−$35,420,775	9%
Securities bearing Fixed and Contingent Charges	46,925,539	17,501,020	− 29,424,519	38%
Total Securities	58,477,109	27,501,020	− 30,976,089	48%
Fixed Charges	1,981,059	210,000	− 1,771,059	11%
Total Fixed and Contingent Charges	2,461,284	910,000	− 1,551,284	37%

[1] Per balance sheets given in Biddle Committee Report.

[2] A syndicate, holding $2,500,000 in Collateral Certificates consented to take common instead of preferred stock in the new Company. This represented a sacrifice on the part of the syndicate.

The details of the exchange of securities can be seen at a glance from the table given on the preceding page. The 5% preferred stock was not to be cumulative until two years, and then involved dividend payments of only $700,000, in contrast with the fixed and cumulative charges on the old securities of over $2,000,000. The preferred stock could be exchanged into common stock at the rate of $150 in common stock for each $100 in preferred. The new Company was to be protected by Voting Trustees during a period of ten years.

Almost as soon as the plan was announced, opposition arose from two quarters.[1] It failed, however, to interrupt the reorganization proceedings; and on September 20, 1902, William F. Harrity was quoted as saying, "The amounts (of securities) deposited justify the committees in declaring the plan of reorganization operative."[2] On October 2d this was done.[3] During the latter part of December, 1902, the various trustees[4] instituted suit in the United States Courts for the sale of the assets of the two companies, and the suits were all consolidated by Judge Kirkpatrick. On April 3, 1903,[5] he signed a decree authorizing the sale of the entire assets of the subsidiaries of the National Asphalt Company. The lowest price to be accepted, the "*upset*" price so-called, was fixed at $6,000 000. On May 15, 1903, the entire assets of the whole asphalt group of companies was bid in by one Henry C. Everdell, for $6,006,000.[6] Three

[1] July 23, 1902, Hannah V. Gallagher, a holder of $21,000 Asphalt Company of America, Collateral Certificates brought suit in Philadelphia to have the plan declared illegal.

July 24, 1902, Wm. C. Bullitt sent out a long letter in opposition to the plan. Letter was published in *Philadelphia Ledger*, July 25, 1902.

[2] 75 *Chron.* 613.

[3] Securities deposited: —

88% Asphalt Company of America's Collateral Certificates.
76% National Asphalt Company's Collateral Certificate.
88% National Asphalt Company's Preferred Stock.
83% National Asphalt Company's Common Stock.

[4] L. T. & T. Co. of Philadelphia for the A. Co. of Am. 5's; Equitable T. C. of Philadelphia, for National Asphalt 5's.

[5] L. T. & T. Co. *v.* A. C. of Am., Consolidated Cause. Record, 385.

[6] Class I, Assets Asphalt Company of America deposited with Land, Title and Trust Company, $3,120,000. Class II, other assets of Asphalt Company of

days later Judge Kirkpatrick confirmed the sale. Behind Everdell stood the Reorganization Committees, ready to take the composite mass of assets in behalf of a new Company. On the day following the sale, May 19th, the General Asphalt Company was incorporated at Trenton, New Jersey, as the legal successor to the asphalt consolidation. During the following month, interim certificates of the new Company were given for the deposited Collateral Certificates representing the securities of the old companies. The exchange was effected exactly on the basis of the reorganization plan of July 18, 1902. Later, the new securities of the General Asphalt Company were admitted to the privileges of the Philadelphia Stock Exchange, and to all intents and purposes the reorganization of the bankrupt asphalt consolidations was accomplished.

There remained only the winding up of the affairs of the old companies. Those of the holders of the old Asphalt Company of America's Collateral Certificates who had not deposited them in accordance with the Plan of Reorganization were offered $104.68 [1] for each $1,000 certificate, as a proportionate share of the proceeds realized from the sale of the assets. Later $6.26 was added from the sale of certain unpledged property. For each Collateral Certificate of a par value of $1,000 a holder who was unwilling to concur in the Plan of Reorganization was paid $111, — approximately one-eighth of his original investment, had he purchased the Certificates soon after the promotion of the enterprise.

The most serious litigation met with in the winding up of the affairs of the Companies was in the suits instituted by Mr. William C. Bullitt. From the time of the announcement of the Plan of Reorganization, Mr. Bullitt was in active opposition to the measures taken by the Biddle Committee. He had pur-

America, $260,000. Class III, Assets National Asphalt Company, $2,619,760. Class IV, National Asphalt Company interest in stock of Asphalt Company of America, $6,240. Decree confirming sale filed May 18, 1903.

[1] Reached as follows: Proceeds of sale of assets of Asphalt Company of America deposited with Land, Title and Trust Company, $3,120,000. Balance of "investment fund in hands of Land, Title and Trust Company, $28,780.74. From the sum of these two deduct costs, fees, etc. The remainder divided by the total outstanding certificates gives $104.68034.

chased, in the open market, $25,000, par value, in the Asphalt Company of America's Collateral Certificates, at prices ranging downward from 93½% to 36%. Representing his own holdings, and about $300,000, par value, of other Certificates, he tried to secure a better settlement than that offered by the Reorganization Committee, through resort to the courts. After adverse decisions on two appeals, a third appeal was allowed Mr. Bullitt's counsel, John Douglass Brown, Esq. At this point, interests representing the General Asphalt Company took over, on October 18, 1904, the Collateral Certificates represented by Mr. Bullitt, at 50% of their par value. This was nearly five times the amount previously paid those other holders of the Certificates who had not participated in the Plan of Reorganization.

One incident of the reorganization is deserving of at least a casual mention. Receiver Tatnall reported to the court on July 6, 1903, certain facts concerning the promotion of the Asphalt Company of America which indicated that a secret promoters' profit had been made by Barber, Elkins, Widener, Greene, Crocker, and the others concerned in the formation of the Asphalt Company of America. The report embodied a petition that Judge Kirkpatrick authorize the prosecution of suits against the promoters to recover any alleged secret profit. The Receiver was unable to push his suits, as Elkins, Widener, and others had, in the meantime, bought up all [1] the outstanding Certificates not taken care of in the reorganization. They were, therefore, able to contend that the Receiver represented no one in his suits against them.

The reorganization of the Asphalt Consolidation was fully accomplished, when the General Asphalt Company inherited the assets of the Asphalt Company of America and the National Asphalt Company; and these companies had ceased to exist. We can, therefore, turn aside from the detail, and note the broader issues involved. The Asphalt Consolidation was the climax of a series of efforts to inhibit competition through combination. Previous attempts had been at least partially successful, and the promoters of the new consolidation sought to gather

[1] Except $2,000 which were never traced, — probably lost.

under one control all sources of supply, and all avenues for the sale of the finished product. The hugh mass of securities which they offered to a willing public was not created as an intended fraud, but on the expectation of two monopoly profits, — on the one hand, the control of the world's supply of raw asphalt, through ownership of all the available sources of supply, on the other hand, the control of the sale of the finished product, through prestige and the manipulation of municipal contracts. The Company failed because neither expectation was realized. Behind this failure are to be found three fundamental causes. Foremost is the fact that competition could not be suppressed. There were other sources of raw material not included in the calculations of the promoters. There were smaller companies, which stood ready to grasp any share of the paving contracts not too tenderly guarded. Moreover, the heavy fixed charges with which the promoters loaded the Asphalt Company of America stifled any freedom of action. Although relying on a theoretical computation of earnings, based on previous results, the promoters took no untoward circumstances into consideration, nor did they safeguard their company against the ordinary hazards of an industrial enterprise. Had their basic securities been stocks instead of bonds, the Company would have weathered the storm. But the fixed charges were determined on the expectation of monopoly and bankruptcy became inevitable the moment the props of monopoly began to slip. Those close to the management applied palliatives for a short time, but their measures served only to make the final fall the more precipitous. The pity was that their palliatives were vitiated by deceit, which gave the closing scenes of the drama a moral as well as an economic significance. The third primary cause of failure was personal. Through every line of the preceding narrative has run the play of human emotions, passions, and ambitions. While this is true to a greater or less extent with the history of every large business, it is conspicuously true with the Asphalt Consolidation. The original companies, being small compact organizations, were able to elicit the undivided loyalty and devotion of their directors and officers. The greatest force in business management, the

mutual confidence and friendship among the managing forces, was there in its best form. The men had developed the asphalt business together, and had a devotion to it approaching the devotion of a parent toward its child. For this compact organization was substituted the large, disorganized form of a great holding corporation. The real ownership of the business drifted from the hands of its founders. With it, too, drifted their individual responsibility. New men assumed positions of importance, petty jealousy sprung up where before there was only mutual confidence, and as the ties of organization became less personal, the Asphalt Consolidation crumbled to pieces.

CHAPTER XVII

The Promotion of the United States Shipbuilding Company

The promotion, 466; the first proposed consolidation, 468; the appearance of the Trust Company of the Republic, 471; the prospectus of April 19th, 473; the underwriting, 474; the prospectus of June 14th, 475; description of the yards to be consolidated, 475; probable value of the yards, 480; earning capacity of the yards, 481; misrepresentations of the prospectus, 482; the Bethlehem Steel Company, 484; the acquisition of the Bethlehem Steel Company, 486; the difficulties of obtaining money, 489; completion of purchase, 491; probable distribution of securities, 492.

Chronological Summary

1898. Attempt to form agreement among shipbuilders.
1899. Beginning of attempt to form consolidation of yards.
1901. Promotion and failure of the first proposed consolidation.
1902. April 19th. Underwriting agreement.
June 14th. Public prospectus and offering.
June 19th. Incorporation of United States Shipbuilding Company.
July 2d. Agreement for acquisition of Bethlehem Steel Company.
August 11th. Actual purchase of the yards.

The attempt to form a combination of shipbuilding yards was one of the most unfortunate episodes in the history of industrial consolidations. Promoted in 1902, the United States Shipbuilding Company was the last combination of magnitude launched during the consolidation movement which began in 1897 and ended in the financial depression of 1903. It came at the close of the period of inflation, after the banking houses and insurance companies had been overloaded with unabsorbed industrial securities, and after an ebb tide had set in among stock market values. The United States Shipbuilding Company was more than a financial blunder. From its first conception, its history was fraught with misrepresentation. It was promoted by a man without financial responsibility and without regard for the fundamental principles of business ethics. Men

of high financial standing lent their names and their influence to the enterprise without personally investigating its nature or the responsibility behind the statements of the promoters. The whole undertaking was conceived under conditions of the most extravagant inflation of industrial values. Had the Company been promoted on the flood tide of business expansion it might have been able to endure, but the financial depression of 1903 stifled its life before it was actually born. A forced reorganization laid bare the details of a structure insecurely built, and only half finished; and the newspapers and magazine "muck-rakers," waiting only for a text to attack the "iniquitous methods of Wall Street" and the extravagance of industrial promotions, explored every crevice of the whole undertaking for anything that might be depicted in a sensational manner. Even the report of the Receiver appears to have been affected by misrepresentation and malice. Now, after a period of ten years, after the heat of personal feeling has subsided, it is more possible to reach an understanding of the facts in something approaching their true light.

Shipbuilding is not, relatively speaking, a successful industry in the United States. Before the Revolution our colonial shipyards were of great importance, but the industry has lost ground during the last century — relatively to its former prominence, — and the decline has been conspicuous since the rapid development of iron and steel ships. During the last twenty years, Government work, especially the building of battleships, has been unprofitable.[1] From reliable evidence, it appears that repair work and the building of small private vessels were the only kinds of work which assured an American shipyard of a liberal margin of profit.[2] In the construction of large vessels,

[1] This statement is made with reference to conditions prior to 1899. It could be made with even greater force if conditions in the succeeding decade are taken into account. This will appear from evidence presented throughout the present narrative.

[2] This is true even of as large a yard as Cramp's. Although doing millions of dollars of Government shipbuilding their profits were largely derived from the Morris Works which they owned — in the case of the Morris Company the profits were obtained from the construction of heavy machinery such as that employed in the Calumet and Hecla mines.

especially battleships, a single yard has always been handicapped, because of the great variety of boats it might be called upon to build, and the wastes incident to carrying a great variety of tools, machinery and patterns suitable to the construction of many types of vessels. For this reason shipbuilders have looked forward to some kind of coöperation among themselves, by which each yard could specialize in the building of a particular class of ships.[1]

The returning prosperity of 1897 and 1898 was felt in the shipbuilding industry. It is difficult to determine who first conceived of the idea of a consolidation of shipyards as a result of the increased activity, but sometime in 1898 the owners of the Newport News[2] Shipyards gave an option on their property to John W. Young,[3] with the understanding that the latter should promote a consolidation of yards.[4] Young had in view a combination of all the important yards and secured an option on the Cramp's. When the latter were asked about the undertaking by other parties, he was not enthusiastic over its success, and in the subsequent steps of the promotion the Cramp yard was omitted from consideration.[5] Young was introduced

[1] A tentative gentlemen's agreement was arranged late in November, 1898, to include those builders who were under contract for new monitors. The plans of the Government had called for single turret monitors. These plans were changed to call for the double turret type. The members of the agreement sought to increase the contract price from $315 to $400 a ton. The agreement amounted to little.

[2] The Newport News yard was constructed by C. P. Huntington, one of the builders of the Central Pacific Railroad, because of his interest in shipbuilding. He hoped that his son would become interested in the undertaking, but the latter preferred research in Spanish history. Later the control of the yard was taken over by Huntington's nephew.

[3] Son of Brigham Young, famous in the history of the Mormon Church.

[4] It appears that the owners of the Newport News Yard intended to recoup themselves, through the high price at which the contemplated combination would take over the yard, for losses already sustained through one of Young's previous enterprises.

[5] *Q.* Who exploited or promoted the combination of 1899 ?

Mr. Nixon. Well, that never came to a head. Mr. Young got a number of options and the Cramps were in it. . . .

(Conklin *v.* U. S. Shipbuilding Co. Testimony before Oliphant, Master. Verbatim record page 1046. Hereafter abbreviated, Conklin testimony.

to Lewis Nixon sometime [1] in the early autumn of 1899. The latter was then a prominent shipbuilder, and well known as a Government expert on naval construction. In the meantime, Col. John J. McCook, a member of the law firm of Alexander and Green, prominent corporation attorneys, became interested in the proposed shipbuilding consolidation, undoubtedly because of his great interest in naval affairs. Young and McCook induced Nixon to give an option on the latter's Crescent yard and adjoining property [2] with the understanding that Nixon

[1] Lewis Nixon was graduated at the head of his class at Annapolis. He was sent by the United States Government to the Royal Naval College at Greenwich to study naval architecture and on his return acted as a Government official at the Roach yard, and was subsequently made chief constructor of the navy. In 1890 he was given the very important work of designing the "Oregon" and sister battleships. Later, he became superintendent of Cramp's works and in 1895 he started his own works, the Crescent Shipyard at Elizabeth, N. J. Subsequently, Nixon rose to influence in New York City politics and became the recognized head of Tammany Hall.

[2] October 25th, 1899.

John J. McCook, Esq.,
120 Broadway,
New York City.

DEAR SIR: —

The properties which it is my intention to turn over to the Co-operative Shipbuilding Combination under the option to which this letter is to give effect are as follows: —

The Shipyard on the Staten Island Sound in the City of Elizabeth, N. J. known as the Crescent Shipyard, having a front of about 400 feet and extending back to Front Street.

The piece of property adjoining the shipyard on the north about 130 feet water front known as the Meta Wharf property.

The piece of Wharf adjoining and north of the last mentioned property, having about 130 feet front and known as the Dolan wharf.

The property of the Samuel L. Moore & Sons Company.

I will sell and deliver to you or your consignee all of the properties above described for the sum of one million dollars ($1,000,000.00) in cash and $500,000.00 in preferred shares at par and $500,000.00 in common stock at par, upon the delivery of said properties, which transfer on delivery shall carry with it all the assets, cash on hand, bills receivable, and all other cash items which are the assets of the Crescent Shipyard and the Samuel L. Moore & Sons Company, together with all their property, both real and personal, all rights, contracts, and the entire undertakings of the Samuel L. Moore & Sons Company, and real and personal property, rights, contracts, and the entire undertakings of the Crescent Shipyard and the shipbuilding business of Lewis Nixon as going concerns.

should consent to act as general manager of the consolidated yards. In due course of time, they were able to secure options on several other shipyards, including the very important Union Iron Works, the largest yard on the Pacific Coast. The details were then arranged, and a firm of New York brokers [1] agreed to receive subscriptions to the securities of the shipbuilding consolidation.[2]

On May 1, 1901, the first definite rumor of the new corporation reached the financial world in the form of the announcement of a meeting at the office of Alexander and Green, held the day previous. This announcement gave the main details of the proposed combination, the capitalization, the yards to be included and the men who supported the combination.[3] The capitalization was stated to be $70,000,000. This figure was repeated in the announcement in the *Commercial and Financial Chronicle.*

All deeds, conveyances or bills of sale necessary to vest all of these properties in the purchaser or his nominee will promptly be executed or procured to be executed by me.

The assets and liabilities of the Samuel L Moore & Sons Company and of Lewis Nixon will be fully shown in the accompanying statements, it being understood that the properties above described are to be free and clear from all liabilities, debts, bonds, debentures or securities by way of mortgage or otherwise and every facility will be extended by us to expert accountants and appraisers designated by you to examine and report upon the books and accounts and as to the values of the above-mentioned properties.

This offer will remain open till the first day of February, 1900.

Yours truly,

LEWIS NIXON.

[1] H. W. Poor & Co., 18 Wall Street.

[2] The first information given to the public regarding the proposed combination was to the effect that a " pool " was being formed to include four large yards. "A coöperation by which a few shipyards shall work to mutual advantage, by placing in each yard the work which it is best fitted to perform." Lewis Nixon in *New York Commercial*, April 26, 1901. According to the newspaper announcement a " central governing board, representing the pool will handle all the Government bids."

[3] This meeting at Alexander and Green's office was attended by H. E. Huntington, Lewis Nixon, Col. J. J. McCook, John W. Young, Alvin Krech, and Henry Poor. The two latter were representatives of the banking interests, but could not in any sense be regarded as promoters. It was proposed to make H. E. Huntington the President of the Consolidation.

Seven days later, on May 7, 1901, the bankers issued the prospectus of the United States Shipbuilding Company, but the capitalization was stated as $65,000,000, half common and half preferred stock. The public were invited to subscribe to the securities on the basis of $100 in preferred stock and $100 in common stock for each $100 in cash subscribed.[1] To attract investors to this proposition, the prospectus advanced two lines of persuasion. Rear Admiral F. T. Bowles was reported to have submitted a report, under date of December 22, 1900, showing under seven headings the probable economies[2] to be effected by the new combination.[3] Admiral Bowles' connection with the government was given marked prominence. Influential men were mentioned as having "consented to serve on the Board of Directors," — E. H. Harriman, H. E. Huntington, Edwin Hawley, and James Stillman.[4] In addition to this use of prominent names, the writer of the prospectus hazards a guess as to estimated profit. "The aggregate orders now in hand" exceed $63,000,000. This, "with the additional business that can be secured, should produce the following estimated results: —

[1] H. W. Poor & Co.'s prospectus of May 7, 1901, page 3. In Moody's *Truths about the Trusts*, page 336, is printed an inaccurate copy of the prospectus. A brief but good summary in 72 *Chron.* 940.

[2] These economies were considered impossible of realization in an article by Charles H. Cramp. (*Philadelphia Telegraph*, April 24, 1901.)

[3] In addition Admiral Bowles is said to have made an appraisal of the values of the yards. This was evidently secret, as I am unable to discover a copy. In all subsequent references to Admiral Bowles' report the results of his appraisals were stated in very summary fashion. Even Nixon never saw the actual details of the report. It was said in the newspaper accounts of the time that Nixon and Bowles would have direct control of the practical work of the shipyards. "The announcement will be made in the near future of the resignation of Mr. Bowles from his position in the Navy Department in Washington." *New York Herald*, May 1, 1901. Bowles remained in the background throughout this and the succeeding promotion. A schedule of promotion expenses said to have been made out by Young indicates that Bowles was to receive $10,000 in cash, $15,000 in bonds, and $25,000 in each kind of stock of the Company as finally promoted. (Conklin testimony, p. 714.)

[4] These men, apparently, lent their names to the undertaking because of the Newport News Yard. H. E. Huntington, nephew of C. P. Huntington, because of the interest of the Huntington family, Edwin Hawley for the same reason, E. H. Harriman, because the yard had been and could be servicable in building large ships for the Southern Pacific Company, and James Stillman, probably, because of Harriman's connection.

Estimated net earnings, 1901		$4,233,000
" " "	1902	5,612,500
" " "	1903	7,500,000
Total estimated net earnings for three years		$17,345,500
Estimated future net earnings, average		5,778,500 [1]

. . . equivalent to a sum equalling 7% on the Preferred and 6% on the Common, and a substantial surplus." [2] These estimated earnings will be considered later, in comparison with other estimated and real earnings covering corresponding periods. Both Admiral Bowles and Mr. Nixon wrote letters in which each of them asserted that the value of the yards was $45,000,000.[3]

Had the public purchased the securities on the presumptions stated in this prospectus, the excuse would have been ample, as the statements were reputed to be those of " eminent experts and Bowles was known as such." But the public did not subscribe to the securities because financial conditions stifled the undertaking at its birth. On May 7, 1901, the date on which the prospectus was given to the public, the famous Northern Pacific corner occurred, and the consequent " panic " in the stock market. Nothing was accomplished, and the whole project was allowed to lapse.[4]

After the failure of the plan, as contemplated in the bankers' prospectus, negotiations with the shipbuilders ceased, except that Young still had confidence in the ultimate success of the undertaking. He went to Paris, ostensibly to promote a bank, but at the same time interested a number of Frenchmen in the shipbuilding promotion. Apparently he secured the consent of a group of men to underwrite the bonds of a new consolidation

[1] It was alleged that these figures were computed by the accountants W. T. Simpson, Riddell and Common, D. W. Folger (for Union yard). Conklin testimony, p. 767. These same accountants appear conspicuously later on.

[2] H. W. Poor & Co.'s Prospectus, p. 2.

[3] Conklin Testimony, pp. 758, 759, 767.

[4] Numerous newspaper " write ups " appeared at the time containing elaborations of the material stated in the prospectus. Rear Admiral Bowles' name, with his Government position, is stated in connection with an " appraisal of values " (*New York World*, May 8, 1901) and much emphasis is laid on the economies of consolidation and the economical distribution of contract work among the yards. It was proposed to build a very large dry-dock which " will eclipse anything of the kind now in existence " (*New York Herald*, May 1, 1901).

which should embrace the majority of yards included in the earlier plan. On his return to New York, in the winter of 1902, Young met Daniel Leroy Dresser, who had recently become President of a new trust company.[1] Young interested Dresser in the shipbuilding undertaking and introduced him to Colonel McCook, who, with Young, still had hopes of a successful combination of shipyards.

Young and McCook then actively engaged in securing the renewal of the old options, and in completing the detailed arrangements for launching the new company. In the course of the subsequent investigation into the details of the promotion, Dresser asserted that various allegations were made to him on the authority of either Young or McCook, the fixing the responsibility of which had much to do with the character of the promotion.[2] Relieved of personal reference, it appears that one of

[1] The Trust Company of the Republic, as it was called, was organized to do a general banking business and in particular to loan money on raw cotton. It had not then opened its doors for business, but the men behind it were well known in financial circles and the Company had every promise of success. A readable, but unfortunately somewhat florid and inaccurate, account of the rôle of the Trust Company of the Republic in the promotion of the shipbuilding combination is given by L. W. Sammis, of the *New York Sun*, in the *Annals of the American Academy of Social and Political Sciences*, Vol. 24, p. 241. The features of this article are the numerous original documents reproduced. Although most of these documents came out in the court evidence and the newspapers, they are more easily accessible in the *Annals*. It ought to be said, however, that many of the allegations made by the writer of the article seem to be without substantial foundation and to be suggestive of the sensational newspaper accounts current at the time the "Shipbuilding Scandal" was receiving public attention.

[2] Various statements were made by Dresser in his testimony which are not borne out by other evidence. In fact, one of the most difficult things in this shipbuilding case is to get at the actual facts. When the promotion came under the review of the courts, every man connected with it was put on the defensive, with respect both to testimony and public opinion, and his tendency was naturally to shift responsibility to other shoulders.

In regard to the early stages of the promotion it appears in the Conklin testimony that McCook told Dresser that the "Mercantile Trust Company had obtained abroad $6,000,000, of underwriting to the United States Shipbuilding Company." "He wanted us (so Dresser testified) to obtain $3,000,000, in this country, and we were to act as the registrars or transfer agents of the stock, and bank of deposit of the Corporation, after it was organized, and that proposition I submitted to my executive committee." (Page 19.) McCook showed Dresser the statements of auditors employed by him (p. 227), giving the values and earnings of the plants.

the promoters represented to Dresser at least these facts (1) that about $6,000,000 of the bonds of the combination had been underwritten in Europe, (2) that the reports of the accountants showed liberal profits for the combination on the basis of contracts already taken, and (3) that "eminent experts" had reported that the combination of shipyards would prove a mercantile and financial success. Apparently Dresser presented the details to the Executive Committee of the Trust Company of the Republic[1] whose members authorized him to proceed with the undertaking and subsequently, according to Dresser's testimony, they authorized him to enter into a contract with Young for securing the underwriting of $3,000,000 of bonds in America.[2]

Meanwhile Young had induced most of those who had given options on their yards for the previous undertaking to renew

He introduced him to Nixon (p. 19), whom Dresser understood to be a leading "expert"; he showed him the valuations of Bowles. Now it seems highly improbable, to say the least, that so shrewd an attorney as McCook would have stated that the Mercantile Trust Company, of which he was a Director, "had obtained" the $6,000,000 of foreign underwriting when, apparently, all the Trust Company would have to fall back upon was Young's statements while a part of the underwriting even Young had not arranged. Furthermore, it is a great question whether the accountants were employed directly by Young or McCook. Young represented, in negotiations with certain of the vendors, that he had employed the accountants. He was the only person, apparently, who possessed their detailed statements. Again McCook did not introduce Nixon to Dresser, but rather Young telephoned for Nixon to come up from Staten Island to New York in order to get him to renew his option and incidentally to meet Dresser. Young told Nixon over the telephone that "he had the project all financed." Collateral evidence points clearly to the fact that Young was still the promoter, as he had been of the first combination, and that McCook actively coöperated with him in furthering the plan, but could not be considered responsible for certain misrepresentations. It must be remembered that McCook was not put on the stand in the course of the Conklin testimony, and given an opportunity to rectify any misrepresentations made by others.

[1] Charles M. Marvin (A. M. Kidder & Company), Stuyvesant Fish, Charles F. Brooker (New Haven, American Brass Company), Charles W. Wetmore (North American Company), Herbert L. Satterlee, Dresser, and the Vice-President.

[2] Conklin testimony, p. 19. Although the members of the Executive Committee had ample opportunity to deny Dresser's testimony, they did not do so. It is fair, therefore, to assume that the final responsibility of the Trust Company's connection with the undertaking belongs quite as much, if not more, with them as with the President.

them for this promotion.[1] With the options in hand, Young and Dresser caused to be circulated a "Private and Confidential" prospectus of the United States Shipbuilding Company, dated April 19, 1902. No copy of this reached the financial press. The Trust Company of the Republic appears on the first page as "Bankers," and Alexander and Green as Counsel. After enumerating the plants, options on which were in the hands of the promoters, the prospectus states that the new Company will have an authorized issue of $16,000,000 of bonds, $10,000,000 of preferred stock, and $10,000,000 of common stock. Of the bonds, $9,000,000 were to be underwritten at 90%, $5,500,000 were to be "withdrawn from Public Issue for Disposal under the Vendors and Subscribers' Contracts, and $1,500,000 to be reserved in the Treasury of the Company."[2] The underwriters were to be given $2,500,000 of both preferred and common stock besides profits from the sale of the bonds to the public, in consideration of their subscription. The plan involved the marketing of $9,000,000 of bonds and $5,000,000 of stock for $8,100,000. This would provide the Company with working capital, and money to pay for its yards. The proposed distribution of securities is best illustrated from a memorandum that McCook handed to Dresser, at the time the negotiations with the Trust Company of the Republic were under way.[3] An examination of this first proposal shows that, out of the $20,000,000 of stock, some $8,000,000 was to go to the owners of the plants, $6,000,000 to the underwriters and their agents, and the remaining $6,000,000 to the promoters. Another and fuller statement of the distribution of the securities is given on page 492.

[1] The owners of the Newport News Yard, however, did not enter the new combination, and thus Huntington, Hawley, and Harriman were not in any way connected with the Company, nor spoken of as probable directors.

[2] Prospectus of April 19, 1902, p. 1.

[3] Mr. Deming of Alexander and Green stated to the writer, "I think it can be shown by living testimony that the memorandum was written by Young and given by him to Dresser. It suited Dresser's plans to swear that it was given to him by McCook." Mr. Nixon stated "I think this (the memorandum) was prepared by Young for the information of the Trust Company of the Republic though it may have been delivered by McCook." Memorandum given in full as Complainants' Exhibit, 64 Conklin testimony, p. 326.

This plan was arranged in April, 1902. During May, Young was actively engaged in Paris securing underwriters for the $3,000,000 of bonds he had proposed to sell in France. One Baron P. Calvert-Rogniat was prominent in securing signatures to the French underwriting agreement.[1] There seems no doubt that Young represented to Calvert-Rogniat, that the American public were eager to buy any form of industrial security, and that all the promoters had to do was to offer their goods to the people and the issue would be over-subscribed. Under these conditions, the Frenchmen would obtain their bonus of stocks without taking over a single dollar's worth of bonds. On the basis of this prospect, Calvert-Rogniat secured the nominal subscription to $4,250,000 worth of bonds. While the foreign underwriting was being arranged, Mr. Dresser endeavored to fulfill his part of the agreement by securing the underwriting of $3,000,000 in this country. In this he had no difficulty, and in a period of less than two weeks he had completed his allotment. Prominent men subscribed, which shows how thoroughly the financial world believed in the success of the Company.[2] No special effort seems to have been made by the promoters to secure the English underwriting to $3,000,000 as had been planned. Accordingly, when it seemed as though the Frenchmen would take $1,250,000 more than their allotment, one of the promoters proposed that the Trust Company of the Republic should be allowed the remaining $1,750,000 not yet underwritten. Mr. Dresser and his Executive Committee fell in with this proposal, prompted by the large additional commission and bonus. As things stood, therefore, at the end of May, 1902,

[1] An amusing summary of these French underwriting transactions is given in an article in the *New York Evening Post*, January 6, 1904. Young was presented to a number of Frenchmen whom he believed responsible. They secured the underwriting. In France, there is no recognized public way of ascertaining the responsibility of a man; one must judge by appearances, and appearances are said to be often deceitful, — apparently so among French financiers.

[2] Of the Executive Committee of the Trust Company of the Republic, C. W. Wetmore subscribed $200,000, and Stuyvesant Fish, $50,000, on their personal account, and authorized as well a subscription on the part of the Trust Company. Chas. M. Schwab subscribed $500,000, Edwin and George Gould, $100,000 each, and other more or less prominent names appeared on the subscription list.

the Trust Company of the Republic had secured the underwriting of $4,750,000 of the $9,000,000 of bonds to be offered the public, and the remaining $4,250,000 had been underwritten in France. One thing only remained, — the sale of the bonds to the public.

On June 14, 1902, the Trust Company issued a public prospectus of the United States Shipbuilding Company, asking for subscriptions to $9,000,000 "First Mortgage Five Per Cent Sinking Fund Gold Bonds" at 97½. In the authorized announcement, inserted in the *Commercial and Financial Chronicle*. Mr. Dresser takes great pains to state that the present undertaking had no connection with the previous promotion which ended disastrously. Yet, with the exception of a few changes in the Companies to be merged, and a more complicated system of capitalization, the two promotions were identical. Even the old report of "Naval Constructor, F. W. Bowles (now Rear Admiral and Chief Constructor of the U. S. Navy)" alleged to have been submitted, December 22, 1900, reappears summarized under the same seven captions. The same accountants certified to the contracts of work then in hand, and the same attorneys "certify as to the validity of the organization, and the title of the Company to the property acquired."

Before narrating the further steps of the promotion, it may be well to consider the companies which the United States Shipbuilding Company was organized to consolidate. (*a*) Of the yards entering the consolidation, the Union Iron Works at San Francisco was distinctly the most important. It was, and still is, the largest yard on the Pacific Coast. Some of the finest vessels of the American Navy have been built here.[1]

[1] It had built Admiral Dewey's Flagship Olympia, and was then building the Ohio, South Dakota, California, Tacoma, and Milwaukee. The most notable achievement of the Yard was the construction of the Oregon designed by Lewis Nixon. Subsequently it was alleged that the yard was not of great value, but the following letter from John D. Long, Secretary of War, would indicate that the yard had excellent facilities for building large battleships: —

NAVY DEPARTMENT,
WASHINGTON, July 21, 1898.

SIR: —

It becomes my pleasant duty to extend to the shipbuilding firm of which you are president the congratulations of the Navy Department upon the admirable

The plant had been very profitable in the years immediately before the combination, but in 1902, the competition of smaller yards and unprofitable government work had reduced the earnings to a low figure.[1] (*b*) The Bath Iron Works and the Hyde Windlass Company were located at Bath, Maine. The former was a large shipbuilding yard with relatively modern equipment. It made a specialty of steam yachts, and did some government work. At the time it was taken over by the Shipbuilding Company, it had undertaken unfortunate contracts, and was burdened by a heavy floating debt. The Hyde Windlass Company manufactured ships' equipment. It

qualities which have been displayed by the United States battleship 'Oregon.' Without going into detail with which it may be safely assumed you are as well acquainted as the Department, it is sufficient to say that the performance of this vessel in making, under circumstances of grave exigency, the voyage from San Francisco, California, to Key West, Florida, without delay or accident of any kind is of itself highly creditable to her builders, but the fact, that after having successfully accomplished such a voyage, the vessel was found to be ready at once, without repairs or attention, to enter into the activities of an important naval campaign, render her achievement most memorable as one which challenged the admiration of naval experts throughout the world and becomes a subject of especial gratitude and pride on the part of our own people.

The Oregon is in all of her complicated parts of American design, material and workmanship, and she has shown herself to possess the highest qualities sought to be attained in a great battleship — a wide, practical radius of efficient action, and splendid fighting capabilities. Since these results are not achieved by accident, but reveal high technical ability as well as thoroughness and honest fidelity in the countless details of construction, I have considered it proper to address to you this expression of the appreciation of the Department of the manner in which you fulfilled your contract in building the United States battleship 'Oregon.'

Very respectfully,

(Signed) JOHN D. LONG, *Secretary.*

TO MR. HENRY T. SCOTT,
President of the Union Iron Works,
San Francisco, Cal.

[1] Much of the success of the yard had been due to the administrative and technical ability of Irving M. Scott, although the credit for the work of the yard was quite frequently ascribed to Henry T. Scott, the President and largest stockholder. When it was proposed to form the United States Shipbuilding Company, the promoters first decided to make Henry T. Scott the President. Mr. Scott left California for the east, with this in mind, his departure being the occasion of a celebration by his friends. Subsequently, Lewis Nixon was selected for the Presidency, because of his great knowledge of naval design and construction. The jealousy resulting from the selection of Nixon was a handicap to the Company.

was of small size, relatively speaking, but its business had been profitable.[1]

(*c*) The Eastern Steamship yard was located at New London, Connecticut, on land leased from the New Haven Railroad. It was of considerable size; it was indeed the only one of the Company's yards on the Atlantic seaboard where heavy battleships could be profitably constructed.[2] Already two large passenger vessels for the Great Northern Railroad's Japan Service had been built here, but the yard had no contract on hand when its management was assumed by the United States Shipbuilding Company.[3] (*d*) The Harlan and Hollingsworth yard had been in operation a long time, and its reputation had in former years been high. Latterly, however, it had not been profitable, its equipment was antiquated and out of repair. It was not suited to large work. (*e*) The Crescent Yard was taken over in 1895 by Lewis Nixon, on land leased from Samuel L. Moore & Sons. This latter concern should be considered with the Crescent as Nixon acquired options on the stock of the Moore Company during the spring of 1902, and turned the two plants over to the Shipbuilding Company as one property. The yard, although small, was very efficient, and under Nixon's personal superintendence had paid well. In fact it had an excellent reputation for turning out small work in notably short time. Nixon had invented a number of tools not found in other yards, and had brought the yard to a high state of efficiency.[4] The Moore plant manufactured engines and fittings.

[1] Both of these Companies were established by General Hyde, but at the time in question they were under the management of John S. and Edward W. Hyde, sons of General Hyde.

[2] Opinion of Lewis Nixon.

[3] The Yard was established by Charles R. Hanscom and Charles Morse in 1900. Hanscom had been with the Hydes at their Bath works. His success there had not been pronounced, especially on the side of financial administration. Morse, had a notable career in financial circles, especially in connection with the American Ice Company, and the coastwise shipping. Subsequently, he was sent to the Federal Prison at Atlanta, on account of financial irregularities. He was released on the plea of ill health.

[4] This should be noted particularly as it was intimated at the time the reorganization came under review that Nixon's yard was particularly poor. An attempt

(*f*) The last of the properties mentioned in the circular of June 14, 1902 as constituents of the new shipbuilding combination was the Canda Manufacturing Company, of Carteret, New Jersey, organized to manufacture railroad cars, which after an existence of ten years, had proceeded as far as the wheels.[1] At the time, it was experimenting on the manufacture of "quadricycles,"[2] but it had never manufactured any materials used in the construction of ships.[3]

The terms upon which these properties were acquired by the Shipbuilding Company may be best seen from the table on the next page.

Various values were placed upon these yards by the promoters. The public prospectus of June 14, 1902, stated that the plants had been appraised at $20,000,000.[4] Subsequent investigations were unable to fix definitely the details and the circumstances of the appraisal.[5] John D. Livingston, Vice-President of the

was made to discredit his yard in order to exaggerate the profits that Nixon received from the promotion. It appears from other evidence that Nixon had been in a position to dispose of the yard at an earlier time for almost as much as the promoters paid him.

[1] Q. What sort of a plant was constructed by the Canda Manufacturing Company?

A. (Mr. Canda). The first intention was to build cars —

Q. Was that intention carried out?

A. (Mr. Canda). Partly.

Q. To what extent?

A. (Mr. Canda). To the manufacturing of car wheels. (Conklin testimony, p. 451.)

[2] *Ibid.*, p. 453.

[3] Conklin testimony, page 460. As a matter of fact, the Candas had advanced considerable sums of money to Young, in connection with some of his previous promotions; and the purchase of the Canda property by the Shipbuilding Company was the method by which the promoters chose to pay the debts.

Nixon testified that he intended to use the plant for manufactúring standardized equipment, when the earlier combination was discussed, but that he recommended leaving it out later. (Conklin testimony, page 724.) The property subsequently proved useless and was dismantled.

[4] Prospectus of June 14, 1902, page 3.

[5] They were based apparently upon statements contained in Bowles' report. Young had got various shipyard owners to value the yards going into the consolidations. The owner did not value his own yard. Bowles seems to have been the only independent "expert" definitely mentioned.

	Chief Owners	Money	Bonds	Preferred Stock	Common Stock	Total Money and Securities	Total Value, Taking Bonds at 90%, Pref. S. at 65%, Com. S. at 25%[1]
		$	$	$	$	$	$
Union Iron Works ..	Scotts	2,750,000	1,027,000	313,000	313,000	4,403,000	3,953,000
Hyde Windlass and Bath Iron Works .	Hydes	850,000	766,000	288,000	288,000	2,192,000	1,798,600
Eastern Steamship ...	Hanscom	500,000	500,000	500,000	500,000	2,000,000	1,400,000
Harlan and Hollingsworth	Gause	800,000	500,000	400,000	400,000	2,100,000	1,610,000
Crescent, Moore	Nixon	900,000	1,357,000	2,199,000	2,199,000	6,655,000	4,100,400[2]
Canda Mfg. Co.	Canda	200,000	300,000	300,000	300,000	1,100,000	740,000
Totals		6,000,000	4,450,000	4,000,000	4,000,000	18,450,000	13,602,000

Trust Company of the Republic, in a private letter to Fisk and Robinson, states that Nixon had written the Trust Company "that the properties were appraised by eminent experts at $18,000,000," and says: "These values, in my opinion, are most conservative, and the plants could not be reproduced for the above sum, and in location, adaptability and readiness, could not be duplicated at all. Combined under one management, which can allot work in such a way that each plant can be utilized on output best suited for its adaptability, I estimate the aggregate value as going concerns at $28,000,000, irrespective of good-will. The value of an established industrial containing the most enterprising of American shipyards and practically all the best available engineering talent, together with the good-will, should not be less than $40,000,000 including every form of asset."[3] Admiral Bowles stated in a letter, "that a very

[1] The prices of the stocks are here figured on the basis of the minimum prices determined by the Harris-Gates pool for marketing the stocks of Schwab and J. P. Morgan & Company. For some months the pool fixed prices above these levels by wash sales.

[2] A large part of the securities given to Nixon was in consideration of his willingness to become President and responsible head of the new Company.

[3] Letter of John D. Livingston to Fisk and Robinson, on letter-head Trust Company of Republic, dated August 29, 1902, offering $10,000,000 bonds. This letter shows the representations the Trust Company of Republic was making during the summer of 1902, in order to market the bonds. The letter passed out of the hands of Fisk and Robinson at the time of their failure. It will be referred to later in connection with the representations of earnings.

moderate commercial valuation of the earning capacity would, when added to my former estimate, bring the combined value of these works as a commercial undertaking to approximately \$45,000,000." [1] The true values of these properties can be reached only from indirect evidence. The New York Audit Company made a valuation, as of July 31, 1902, the time of the acquisition by the Shipbuilding Company. The Circuit Court determined certain " upset " prices for the yards, which indicate relative values. Altogether it could be said that the plants had an actual tangible value of at least \$8,500,000.[2]

	Auditors' Valuations	Court's Upset
Union Iron Works	\$4,303,379	\$1,400,000
Hyde and Bath	1,185,437	425,000
Eastern Steamship	237,279	125,000
Harlan and Hollingsworth	1,294,767	550,000
Crescent and Moore	875,372 [3]	300,000
Canda	300,000	200,000
	\$8,196,234	\$3,000,000

The promoters furnished \$1,500,000 in cash. We may conclude, therefore, that the total tangible property to be acquired had a replacement value of approximately \$10,000,000. In addition, the good-will of some of the yards was of considerable value, — especially of the Union Iron Works and the Crescent, — but it cannot be appraised.

The combination of shipbuilding companies did not obtain even an approximate monopoly of the operating yards of the country.[4] For example, the New York Shipbuilding Company, organized in 1899, had obtained in the first year of its existence a larger proportionate share of new contracts than any other yard on the Atlantic seaboard. Besides the New York yard, such important shipbuilding concerns as the Cramp, the Newport News, the Fore River, and the Maryland Steel were outside

[1] Conklin testimony, page 758.

[2] Decree of Foreclosure and Sale, June 30, 1904, pages 47–51.

[3] Nixon had been offered \$1,000,000 for his yard. He paid \$400,000 for the Moore stock.

[4] It is very difficult to estimate the percentage of control of the contract ship construction secured by the consolidation. Considering both the Atlantic and Pacific coasts, it was probably in the neighborhood of 35 %.

the Company. Each one of these was larger than any of the United States Company's Atlantic yards. Of approximately \$68,000,000 of ship contracts then building on the Atlantic seaboard, the United States Company controlled only \$19,000,000.[1] On the Pacific Coast, the Union Iron Works was distinctly in the lead, but at that time the Moran and the Risdon Works were rising into prominence.

Turning now to the alleged and actual earning capacity of the yards, we obtain further light on the promotion. In the first prospectus of 1901,[2] it was asserted that W. T. Simpson and Riddell and Common reported that the contracts exceeded \$63,000,000, upon which \$7,000,000 would be earned,[3] and that the net earnings were averaging over \$5,000,000 per annum.[4]

[1] These estimates are based on a private report made at the time. Great care was used in ascertaining the contracts, and I believe them approximately accurate.

[2] It is instructive to compare, on an even basis, the 1901 and 1902 promotions, because apparently the same audit by the accountants was used in both cases. In the second promotion the Harlan and Hollingsworth and the Eastern yards were substituted for the Newport News.

[3] The slightest statistical analysis would have proved this statement an over liberal estimate. The Cramps, for example, had earned about 7 % on their contracts during the preceding fifteen or so years. This estimate presumed that these yards would be earning over 11 % on contracts.

[4] This reference to the earnings on Government contracts in the process of execution calls for an explanation of the method adopted by accountants in estimating earnings on incompleted work. Inspectors of the Navy Department report the relative percentage of completion of each vessel at the beginning of each month. The accountants have, therefore, merely to compute the net cost up to a certain point, compare it with the report of the Government agents as to the percentage of completion, and estimate (1) the amount of contract work unfinished, (2) the profit on the completed work. Although this latter estimate is perfectly legitimate on the basis of accountancy, it is not from the point of view of financial conservatism, as the portions of the contracts unfinished may cost more, proportionately, than the portions finished. In addition the estimates of the Government inspectors, although based on the most careful investigation, are often wrong.

The following table, taken from the monthly summary of naval construction issued by the bureau of construction, shows the public character of the Government estimates: —

	Battleships	Degree of Completion February 1	March 1
Illinois	Newport News	88	90
Maine	Cramp & Sons	42	44
Missouri	Newport News	23	25
Ohio	Union Iron Works	37	39

In the prospectus of June 14, 1902, the yards were stated to have contracts aggregating $36,000,000 upon which, $5,000,000 in profits would be realized.[1] The annual net earnings were alleged to be $2,225,000.[2] In a letter under date of August 26, 1902, Vice-President Livingston, of the Trust Company of the Republic, stated that the accountants reported profits for the year ending June 30, 1902 as $1,942,522.[3] The independent auditors estimated that, on the basis of the contract work finished July 31, 1902, the net earnings on the contracts could not amount to $5,000,000 as alleged in the prospectus of June 14, 1902, but might reach $1,660,000.[4] Subsequent revelations indicated that

[1] The writer of this prospectus presumed a contract profit of 14 %.

[2] "The bonds are secured by a first mortgage on the above-mentioned plants, appraised as going concerns, at more than $20,000,000 in addition to which these companies will have a working capital of more than $5,000,000, and the constituent companies have now on hand contracts for work amounting to more than $36,000,000, on which the profits are estimated at over $5,000,000, or more than sufficient to pay interest on bonds and sinking fund for five years. These plants are earning $2,225,000 per annum on the contracts now on hand, and have abundant facilities for additional woik and increased earning capacity, —

		$2,225,000
Fixed Charges, 5 per cent on $16,000,000	$800,000	
Sinking Fund	200,000	1,000,000
		$1,225,000
Less Annual Dividends:		
Six per cent on Preferred Shares, $10,000,000	$600,000	
Leaving for Dividend on Common Shares, betterments and repairs, per annum	625,000	1,225,000"

Prospectus of United States Shipbuilding Company, dated June 14, 1902.

[3] Quoted at length in letter of August 26, 1902 to Fisk and Robinson. This figure formed the basis upon which Livingston sought to dispose of the bonds to banking houses, and upon which A. C. Gary, as Treasurer of the Shipbuilding Company, later based his representations in the application to have the stocks of the Company admitted to the list of the New York Stock Exchange. Application A-2726, dated December 24, 1902. Reprinted 76 *Chron.* 493.

[4] Report of independent auditors, made on basis of work on contracts completed up to July 31, 1902. In the prospectus of June 14, 1902 (see note 2, above) it was alleged that the contracts amounted to "more than $36,000,000." It appeared later that the actual amount of contract work in process of execution on June 14, 1902 was $34,377,409, but that over $13,000,000 of this work had been completed. It is clear that a failure to state the amount of contract work already done in the prospectus gave an exaggerated importance to the contracts.

the profits of these contracts, actually realized, were less than \$400,000.[1] The annual earnings were not "\$2,225,000 on contracts now on hand" but turned out to be \$833,459 [2] for the year following the promotion.[3] There were also several misstatements regarding the Directors, the organization of the Company, and matters of minor consequence. Considering the fact, however, that the public did not subscribe to the bonds on the basis of these various allegations, the misrepresentations contained in the prospectus cannot be said to have had much practical significance.[4]

[1] Estimate of \$1,078,261 on basis of completed work, July 31, 1903. During 1905, \$250,000 over-estimated earnings, and in 1906, \$439,093 was again charged off by the reorganized company "on Government Cruisers contracted for by the United States Shipbuilding Company." (1906, Beth. Steel Corp. Rep. 18.) In this way at least \$689,093 of estimated profits disappeared. It should be remembered, however, that the Receivership, strikes, Government penalties and other unfortunate incidents had a most disastrous effect on the earnings of the yards.

[2] Estimate of Audit Company of New York. The estimate of the Reorganization Committee Circular of May 25, 1903 gives earnings as \$750,000. Both estimates were, apparently, unduly severe, and the yards were suffering under the disadvantages mentioned in the previous note.

[3] The unfortunate estimate of \$2,225,000 a year was gleaned from comments of Nixon, as to what the latter thought he could earn from the yards when he had introduced new methods and more efficient management. Dresser changed this expectation of the future to a statement of actual fact, on his own authority, apparently.

[4] Besides the distribution of the prospectuses, an elaborate advertisement covering the prospectus appeared in the June 14, 1902 issue of the *Chronicle* (74 *Chron.* 1928, XI). This attracted little interest and practically no purchasers.

It has been difficult to determine definitely who were the authors of the prospectus of June 14th. Dresser said that it was prepared by Mr. Deming, of Alexander and Green. This is obviously incorrect. Deming reached New York from a yachting trip, on June 7, without any knowledge of the shipbuilding promotion. The prospectus was out June 14. It had been prepared some time before, as Dresser's own testimony shows. Moreover, the prospectus states that the Company "had been organized," while the starting papers were on Deming's desk at the time of its issue. In all probability, the prospectus was written by Dresser and Livingston themselves, and its authorship denied when criticism centered upon it. McCook did not authorize the statements made in the prospectus. (McCook's own denials under oath.) Nixon did not see the prospectus until it appeared as an advertisement in the daily papers.

Dresser testified that it was "O. K.'d" on the margin by Alvin Krech, of the Mercantile Trust Company. (Conklin testimony, p. 265.) This was denied absolutely by Krech in his testimony and subsequently. (Kavanaugh *v.* Mer-

While the prospectus was being put through the press, other events occurred which proved of great moment in the fortunes of the Company. According to Dresser's testimony,[1] he was lunching with Nixon, on June 11, when Charles M. Schwab came up to them and said, "Why don't you buy the Bethlehem plant?"[2] The Bethlehem Steel Company had arisen through a reorganization of the old Bethlehem Iron Company. The latter concern had owned and operated a large, but antiquated, plant at South Bethlehem, Pennsylvania, for over twenty years.

cantile Trust Co., *et al.* Answers of Defendent Alvin W. Krech, folio 7, sworn to March 1, 1904.) And furthermore, it is not conceivable that a careful banker, like Krech, would have permitted the prospectus to appear with his sanction, considering the misrepresentations it contained. The whole connection of the Mercantile Trust Company and Alvin Krech with the second promotion was due to the solicitation of the Trust Company of the Republic, as is attested by the following letter: —

TRUST COMPANY OF THE REPUBLIC
71 WILLIAM STREET, NEW YORK, July 22, 1902.

THE MERCANTILE TRUST COMPANY,
NEW YORK CITY.

GENTLEMEN:

In the underwriting agreement, dated April 19, 1902, relating to the bonds of the United States Shipbuilding Company, the name of your Company was inadvertently used in place of our name. Instead of changing the agreements which have been already executed by the underwriters who are ready to act under the same, we prefer to ask you to act as our agent in the matter and in furtherance of this suggestion, we hereby request you to take such action under said agreements as may be requested by our counsel, Messrs. Alexander & Green, and agree to hold you harmless from or on account of any action you may so take, including all liability for any money to be paid under such direction of yours. Furthermore, we will procure from the United States Shipbuilding Company such authority as may be necessary to put you in possession of a sufficient amount of the preferred and common stock and bonds of that Company to enable you to meet the requirements in stock and bonds of such underwriters as may make payment to you under their aforesaid agreements, and when you are protected to your satisfaction in this respect, you are to turn over to us moneys received by you from the underwriters.

Yours very truly,

J.D.L.-D. (*Signed*) DANIEL LEROY DRESSER, *President.*

[1] Conklin testimony, pp. 69, 482.

[2] Schwab was then President of the United States Steel Corporation, and later testified that his chief interest in the shipbuilding combination lay in the fact that it would be a large customer of the Steel Corporation. He had already subscribed to $500,000 of the shipbuilding bonds, as a member of the underwriting syndicate. Note 2, p. 474.

The dividend yields of the Iron Company had been liberal, and its general policy conservative. On April 17, 1899, the Bethlehem Steel Company had been organized under Pennsylvania laws, and this immediately leased the Iron Company by guaranteeing payment of 6% on the $7,500,000 capital of the latter. The Steel Company had itself $15,000,000 capital, on which only $300,000 had been paid in.[1] Two years later, August 16, 1901, the Bethlehem Steel Company's stock had been taken over by the United States Steel Corporation underwriting syndicate, headed by J. P. Morgan and Company. The price paid for the $15,000,000 stock was $7,200,000,[2] or twenty-four times what had been paid in on the stock two years before. At the time that this transfer occurred, the Bethlehem Steel Company gave $7,500,000 of its own 6% bonds [3] for the equal amount of Iron Company stock, and thus acquired actual title to the assets of the Iron Company which then ceased to exist. At the time the negotiations between Schwab and the Shipbuilding Company's promoters occurred, the Bethlehem Steel Company was burdened with $8,851,000 in bonds, carrying fixed charges amounting to $517,550, but Schwab showed Dresser and Nixon that the net earnings then amounted to about $1,400,000 over and above the fixed charges.[4] He agreed to sell the promoters of the United States Shipbuilding Company the Bethelehem stock for $7,200,000 in money, but the latter were unable to secure this amount.[5] They offered him, however, $10,000,000 of bonds, and $9,000,000 each of the common and preferred stocks of the Shipbuilding

[1] Stock $50 par, $1 paid. For brief summary, see 1905, Beth. Steel Corp. Rep. Moody, *Truth about Trusts*, p. 344, gives a brief summary of old Bethlehem Iron Company. (Not reliable.)

[2] $24 per share.

[3] First mortgage bonds on all the property then owned by the Steel and Iron Companies. These bonds are unusual among industrial bonds, for their long life. (Maturity, 1998.)

[4] Conklin testimony, p. 490. It later developed that this was a modest estimate.

[5] It is very difficult to determine the actual value of this stock. On the basis of evident earning power of the Bethlehem works, this price was very reasonable. On the other hand, it is very doubtful that the Bethlehem works had then a replacement value of over $12,500,000. The equity represented by the stock had hardly more than $4,000,000 of tangible property behind it.

Company.[1] Schwab accepted this offer on the condition that the stock bonus be raised from $9,000,000 of each class of stock to $10,000,000 of each class. He alleged that J. P. Morgan and Company had demanded $5,000,000 in stock in consideration of a profit on the Bethlehem Company's shares.[2]

On July 2, 1902, Schwab contracted to pay J. P. Morgan & Company, as managers of the United States Steel underwriting syndicate, $7,246,871.48, in exchange for the stock of the Bethlehem Steel Company. He then agreed to turn the stock over to the Shipbuilding Company, for $10,000,000 Collateral Trust bonds, to be described presently, and $10,000,000 in each of the two classes of stocks. To accomplish this purchase, Mr. Schwab furnished all the cash required, with the exception of $1,777,000 which was subscribed by his friends.[3] The Collateral Trust bonds issued in connection with this transaction were secured by the deposit of the Bethlehem Steel Company's stock with the New York Security and Trust Company, and by a second mortgage on the shipbuilding yards. The Shipbuilding Company agreed, too, to give these bonds voting power equivalent to a corresponding amount of shipbuilding stock,[4] and to give the trustee of the mortgage the voting power of the Bethlehem Steel stock. Further, the Shipbuilding Company guaranteed a dividend of 6%[5] on the Bethlehem stock, and contracted to

[1] This transaction was arranged by Young, who was then custodian for all the options on the shipbuilding yards.

[2] Schwab told Nixon and Dresser, the latter testified (Conklin testimony, p. 71), that he owned the Bethlehem stock, but later told them that J. P. Morgan and Company owned it in the interest of the United States Steel Corporation syndicate. According to Charles Steele's testimony (*ibid.*, pp. 1537–1543) J. P. Morgan and Company had acquired the stock from Schwab in June, 1901. (Agreement of purchase, dated June 15, 1901, Conklin testimony, Complainants' Exhibits, pp. 123–125). They were now anxious to place it in friendly hands without suffering any loss, as the ownership by the same person of two competitive companies engaged in the manufacture of armament for Government contracts was contrary to law.

[3] Out of the $10,000,000 of bonds acquired by Schwab, $1,777,000, were taken by his friends. Schwab's testimony, Conklin, p. 2211.

[4] United States Shipbuilding Company to New York Security and Trust Company. Mortgage Agreement, Article four.

[5] *Ibid.*, Article five, section 7.

furnish the Company with enough orders to assure this dividend, and a constant working capital of $4,000,000.[1] More exacting terms could hardly be described. In truth, they amounted to the surrender of the shipbuilding yards to the control of the Bethlehem Steel Company. This was what happened.

When all these matters came under public discussion at a later time, Schwab was severely condemned[2] for the exacting terms of his bargain. After a period of ten years, one must modify this judgment. Of all the persons selling their property to the combination, he alone received no money. As it developed, the Bethlehem Company had, in spite of its heavy load of debt, an earning capacity far above all the shipbuilding yards together; and yet the promoters of the combination had contracted to pay $6,000,000 in money for these yards, besides the considerable allotment of securities. Schwab had no prophetic vision which enabled him to forsee the collapse of the project, yet he was certainly entitled to protect his interests in case such a collapse should occur. He had offered to sell his Bethlehem stock for money, and the price he asked for it, on the basis of earning power, was far more reasonable than that asked and received by any others who sold their yards to the promoters. They were insured against the failure of the combination through the money which Young and the others had contracted to pay them; Schwab could be insured only by an agreement which should fortify him against the contingency of failure.

The United States Shipbuilding Company was incorporated June 19, 1902 by three employees of the Corporation Trust Company of New Jersey.[3] Five days later, three dummy

[1] *Ibid.*, Section 8.

[2] Especially by Receiver Smith's report and by Samuel Untermyer, attorney for the public holders of the first mortgage bonds. The judgment of neither was unbiased.

[3] The business of the Corporation Trust Company was to attend to the legal formalities of all incorporations. They had a trained force of clerks who were prepared to become directors, presidents, and secretaries, as the exigencies of the situation required. Considerable emphasis was laid by Receiver James Smith, Jr., of New Jersey, in his report to the Circuit Court, on the fact that the incorporation was entirely in the hands of dummies. Although true, it should be stated that this is, unfortunately, the ordinary method of New Jersey incorporation. If the

Directors accepted an offer [1] from Young,[2] to the effect that the latter should transfer the various shipyards and the Bethlehem stock to the newly organized Shipbuilding Company for securities of a par value of something over $70,000,000.[3] The formal acceptance of the Young offer completed the necessary legal steps to bring the Shipbuilding Company into existence. There remained, however, the actual transfer of the property.

This last step was not easy to accomplish. The first mortgage bonds were offered to the public on June 14th, while the negotiations for the acquisition of the Bethlehem works were pending, and before the Company had actually been incorporated. They subscribed for less than $500,000 of bonds out of a total offering of $9,000,000. On August 11th there was required the $6,000,000 in money necessary to pay for the original plants. The promoters had further agreed to provide the Shipbuilding Com-

Receiver had actually wanted to improve the methods of incorporation, instead of ridiculing this particular example, there was ample opportunity in his own state.

[1] The offer is given completely in Receiver Smith's Report. Pertinent parts of the offer are reprinted in *Trusts, Pools, and Corporations*, edited by William Z. Ripley.

[2] The offer was prepared by Mr. Deming, of Alexander and Green.

[3] To illustrate the actual value of the New Jersey statute, already exemplified in the malting case (*supra*, p. 275), the following brief summary of the legal formalities may be suggestive. On June 24 occurred the first meeting of the shipbuilding directors. These were Raymond Newman, Louis Dailey, and Frederick Seward. They elected themselves, respectively, President, Vice-President, and Secretary-Treasurer. All were clerks in the employ of the Corporation Trust Company, 15 Exchange St., Jersey City, New Jersey. The capitalization was $3,000, fifteen shares each of preferred and common stock. One share was assigned, but not transferred, to each of these dummy directors. The offer of Young was read to these three clerks. They then passed the following resolution:

"Whereas, John W. Young has offered to convey, sell, etc. . . . to this Company all and singular the properties described in this offer which has been spread upon the minutes of this meeting; and,

"Whereas, in the judgment of this Board the value of the properties so offered to be conveyed, sold, assigned, transferred, paid and delivered to this Company is at least the par value of the stocks and bonds of this Company proposed to be issued therefor, to wit, the sum of $70,000,000, and said properties are necessary for the business of this Company

"Resolved, that said offer be, and the same is hereby accepted, . . ." (Minutes of Directors' Meeting of June 24, 1902. Reprinted in Receiver James Smith, Jr.'s Report, filed October 31, 1903, p. 3, which is itself reprinted in part, in *Trusts, Pools and Corporations*, p. 182, edited by William Z. Ripley.)

pany with $1,500,000 of working capital. To meet these payments, — and Schwab had insisted that they must be met before the consummation of the Bethlehem transfer, — the promoters had only the French and American underwriting to rely upon, and the small amount of public subscription. The French underwriting amounted to practically nothing. Extensive correspondence and cables passed between the promoters on this side and their representatives on the other,[1] but the Frenchmen refused to meet their obligations. They excused themselves on the ground that Young had assured them that the underwritings would never be called, and had cabled them that the public offering of bonds was a "success." The Frenchmen must have been at a loss to understand the basis upon which the considerable allotments of stocks had been given them.[2] The American underwriters paid their subscriptions, but, as the French had agreed to take $4,250,000 of the bonds, Dresser and Nixon had not enough money to meet the payments of $7,500,000 necessary to effect the purchase of the yards and the launching of the Company.

The Herculean task of raising this money was undertaken on this side of the water, while Young was engaged in Paris in the futile attempt to secure payments from the French underwriters. At first, Dresser and Nixon were able to secure a considerable amount of money on their own notes supported by the shipbuilding securities. At the time, as well as later, both believed the French underwriting perfectly good, and any temporary

[1] See *New York Evening Post*, October 8, 1903, or *New York Tribune*, October 9, 1903, where much of this correspondence is reprinted. It is humorous, but of no permanent significance. A few of the suggestive cablegrams are given by L. W. Sammis, in his article in the *Annals American Academy Political and Social Sciences*. 24 *Ann. Am. Ac. Pol. Soc. Sci.* 254.

[2] The *New York Evening Post* writer, who evidently looked into the French underwriting with some care, states (*New York Evening Post*, January 4, 1904) that it was a recognized custom of some underwriters to lend their names to an enterprise for a commission, — say 5 % in stock. In such cases, every one connected, except the public, would recognize that such underwriters had neither the ability nor intention of paying anything. Men with nothing but titles were prone to participate in this kind of finance. The Baron, who had obtained many of the subscriptions, was evidently of this kind. He had been in prison for fraudulent practices.

loans could be paid as soon as the money was received from France. The loans from the various sources proving inadequate, and the eleventh of August not more than three days ahead, Dresser appealed for help to Max Pam, Mr. Schwab's attorney.[1] The latter, according to Dresser's testimony, had promised before he went abroad that he would help the promoters to the extent of "two million more,"[2] and now, in the hour of need, Dresser appealed to his representative. Mr. Pam replied "Nothing of the kind."[3] After some discussion, Pam introduced Dresser to George W. Perkins, of J. P. Morgan and Company, and requested him to lend $2,500,000 on the French underwriting securities as collateral. This Mr. Perkins refused to consent to, on the ground that J. P. Morgan and Company did not have control of the shipbuilding enterprise.[4] He did consent, however, to deposit $700,000 in each of three trust companies, the understanding being that Mr. Dresser could re-borrow the amounts. The Knickerbocker, the Manhattan, and the Trust Company of the Republic were named by Dresser. The Manhattan Trust Company refused to accept the deposit on the condition of a loan to the shipbuilding promoters, and the amount was returned to J. P. Morgan and Company. A similar proposition was refused by the Mercantile Trust Company. It was accepted by the Knickerbocker and Republic Companies. Afterward, Dresser negotiated a loan of about the same amount, with the New York Security and Trust Company, of which both Schwab and Perkins were directors, on the strength of the latter's introduction.[5] All these temporary loans, arranged for on the basis of the French underwriting, were secured on the credit of the Trust Company of the Republic, and by the personal endorse-

[1] Conklin testimony (Dresser), p. 97.

[2] *Ibid.*, p. 95.

[3] Conklin testimony, p. 98.

[4] Although J. P. Morgan and Company may not have played a conspicuous part in the shipbuilding episode, they were certainly more than passive spectators. For example, they cabled to Morgan, Harjes and Company, at the request of McCook, — "Charles M. Schwab, and his friends are interested in the new shipbuilding company here, and would be glad to have you take as cordial view as is consistent." (Conklin's testimony (Perkins), p. 1468.)

[5] Conklin's testimony (Perkins), p. 1439.

ment of both Dresser and Nixon.[1] Some were additionally secured by the assignment of the American underwritings.[2]

As a result of these financial proceedings, Dresser and Nixon were able to secure, by August 11, the $6,000,000 necessary to purchase the shipbuilding yards. Of this amount, $250,000 had been subscribed by the Trust Company of the Republic. Besides this, $3,672,187.50, had been borrowed by Dresser, and with the endorsement of Nixon,[3] the major part from the Trust Company of the Republic and other Trust Companies willing to accept its guarantee. The remaining $2,077,812.50 came from the American underwriters and subscribers other than the Trust Company.[4] On August 12th, the Bethlehem Steel Company was acquired under the conditions of Schwab's agreement, and J. P. Morgan and Company received $5,000,000 of the Shipbuilding Company's stock as a bonus.[5]

It is valuable, perhaps, as a summary of these somewhat complicated proceedings, to arrange in tabular form what was intended to be the distribution of the money and the securities. Some of the promoting commissions were never paid.

[1] The exact responsibility for this form of banking is difficult to fix. The Executive Committee of the Trust Company of the Republic certainly did know of the rôle of their Trust Company in the promotion of the Shipbuilding Company. Dresser testified under oath that the Executive Committee authorized him to borrow these sums (Conklin's testimony, p. 155), and that the Committee subsequently confirmed the transaction at the meeting of September 9th. The Directors certainly did reëlect Dresser to the Presidency, when these transactions were known. On the other hand, the Executive Committee was composed of men of very high standing. They must have recognized the seriousness of their responsibility, if they actually did understand themselves as authorizing Dresser to perform these transactions.

[2] Notably the Knickerbocker Trust Company.

[3] It should be noted that Nixon, who understood that he would have the management of the shipbuilding, rather than the financial responsibility, was induced by Dresser to enter these transactions. Dresser gave him to understand that in no other way could the yards be paid for and the Company put on its feet.

[4] These figures are believed to be correct, although arrived at by a process of elimination. They are certainly correct within reasonable limits. The Conklin testimony shows that Dresser and Nixon borrowed, on the credit of the Trust Company of the Republic, $4,100,000, but some of this was borrowed after August 11th.

[5] This they afterwards sold to Schwab for $75,000. (Conklin testimony, p. 1466.)

	Cash	First Mortgage Bonds	Collateral Trust Bonds	Preferred Stock	Common Stock
Public	....	$490,000			
Shipyard Owners	$6,000,000	4,050,000	....	$4,000,000	$4,000,000
Schwab, Bethlehem	....	....	$8,223,000	} 7,500,000	7,500,000
Schwab Syndicate	....	....	1,777,000		
J. P. Morgan & Co. (U. S. Steel Syndicate)	....	....	....	2,500,000	2,500,000
T. Co. of Rep. (underwriting)	....	250,000	....	62,500	62,500
Underwriters other than T. Co. of Rep. (approximate)	....	2,400,000	....	600,000	600,000
Underwritings, largely French which fell back on T. Co. of Rep. (approx.) upon which $4,100,000 was borrowed	....	5,860,000	....	1,500,000	1,500,000
Promotion Commissions[1]					
Trust Company of Republic	67,000	250,000	....	700,000	700,000
Mercantile Trust Company	10,000	20,000			
Mercantile Trust Company	....	20,000	....	75,000	75,000
Alexander & Green	20,000	50,000	....	150,000	150,000
John W. Young (Syndicate C. J. Canda)	....	100,000	....	250,000	250,000
Admiral Bowles	10,000	15,000	....	25,000	25,000
Canda	2,500	1,250	....	2,500	2,500
McGregor (accountant)	....	1,250	....	2,500	2,500
John W. Gates	....	50,000	....	100,000	100,000
Schwab	....	50,000	....	100,000	100,000
Charles R. Flint	....	....	....	25,000	25,000
J. T. Boothroyd	....	....	....	10,000	10,000
E. C. Ellis	....	....	....	5,000	5,000
Special Gifts[2]					
Dresser	....	....	....	....	1,000,000
Nixon (turned over to Sheldon Syndicate)	....	....	....	....	1,000,000
Schwab	....	....	....	..	1,000,000
Pam	....	....	....	....	1,000,000
Trust Company of Republic	....	....	....	....	1,000,000
Promoters (Young)	140,500	892,500	....	2,392,500	2,392,500
Treasury U. S. Ship. Co.	1,500,000	1,500,000			
Total	$7,750,000[3]	$16,000,000	$10,000,000	$20,000,000	$25,000,000

As soon as the Company was established, it was necessary to provide its treasury with working capital. The promoters had agreed to furnish the Shipbuilding Company with $1,500,000 in cash. As the autumn drew on, and the French underwriting

[1] All of these underwriting commissions, except those to T. Co. of Rep., are transcribed directly from a memorandum of Young, dated October 22, 1903, and left with Nixon. (Conklin testimony, p. 714.)

[2] Conklin testimony (Nixon), p. 1149.

[3] Some of the vendors took bonds instead of cash, which reduced the original requirement of $8,100,000.

still failed to materialize, Dresser, with the endorsement of Nixon, borrowed further on the credit of the Trust Company of the Republic.[1] The Company was, by this time, well started on its way, and Lewis Nixon, as President of the combination, assumed the nominal control of the plants, — all save the Bethlehem Steel Company, which retained a separate management amenable to Charles M. Schwab, and his attorney, Max Pam.

Looking at the promotion as a whole, it is perhaps true to say that the original owners of the yards, receiving cash in the first instance, were the only ones who profited in the formation of the Shipbuilding Company, and that this profit did not seem to them undue. The business of the yards was at a low ebb during 1900 and 1901. Every shipyard owner thought the other builders more prosperous than he. In this confused frame of mind, he was ready to believe in the economies of collective ownership and expert management so ably set forth by Admiral Bowles. He listened attentively to Young's scheme, and gave an option on his own yard almost without hesitancy. Each one of these men believed in the success of the combination, and although recognizing that the price he was to receive was out of proportion to the value of his plant, and that the total nominal capitalization of the new company was excessive, he had no difficulty in excusing these excesses as more or less in accord with the customs of industrial consolidation. This is practically the whole matter, as far as the original owners of the yards were concerned.

[1] NEW YORK, January 13, 1903.

Received from Trust Company of the Republic, the following described promissory notes, signed by us, *viz.*:

Note for $750,000 to Harris Gates & Co., dated September 16, 1902, upon demand.

Note for $500,000 dated September 4, 1902, to Manhattan Co., four months.

Note for $500,000 dated September 15, 1902, to the Patterson Safe Deposit & Trust Co., four months.

Note for $500,000 dated August 29, 1902, to the National Park Bank of New York, four months.

Note for $500,000 dated September 4, 1902, to the National Park Bank of New York, four months.

Note for $700,000 dated August 11, 1902, to the Knickerbocker Trust Co., four months.

In the presence of: *Signed* LEWIS NIXON.
H. L. Satterlee: D. LEROY DRESSER.

CHAPTER XVIII

The Failure and Reorganization of the Shipbuilding Company

Difficulties incident to the French Underwriting, 494; the Sheldon syndicate, 495; disappointment in the operation of the shipbuilding yards, 496; diversion of the Bethlehem Steel Company's earnings, 499; first plan of reorganization, 501; controversy over plan of reorganization, 503; second or modified plan of reorganization, 506; summary, 508.

1902.	October.	Formation of the Sheldon syndicate.
1903.	March.	Rumors of financial trouble.
	April.	First plan of reorganization.
	October.	Publication of Receiver's Report.
1904.	January.	Second or modified plan of reorganization.
	December.	Incorporation of Bethlehem Steel Corporation.

It seemed wise to go into the promotion of the shipbuilding combination in some detail, in order to show the unfortunate circumstances which accompanied it. These circumstances, however, did not bring misfortune upon the Company immediately. The most troublesome feature, during the summer of 1902, was the delay in receiving money from the French underwriters, and the consequent trouble the delay caused in the adjustment of the temporary loans secured by Daniel Dresser, then President of the Trust Company of the Republic. After considerable correspondence, he sailed for Europe, the last of September, 1902, intending to see for himself, how much strength there was back of the repeated promises. His trip availed nothing.

While Dresser was in Europe, his Executive Committee became anxious concerning the $4,000,000 or more loans outstanding against the credit of the Trust Company of the Republic. The members of the Committee had been told that these loans would be cared for from the French underwriting. As nothing was forthcoming from this direction, and their date of maturity was approaching, the Executive Committee realized that meas-

ures must be taken to provide for them, or the Trust Company of the Republic would fail. The financial world was in no position, in the autumn of 1902, to endure the collapse of a single trust company, and least of all, one known to be engaged in the promotion of a speculative enterprise. Some time in October, 1902, Stuyvesant Fish, of the Executive Committee of the Trust Company of the Republic, called Lewis Nixon into his office [1] and asked him what he was going to do about the $4,000,000 of notes he had endorsed for the Trust Company of the Republic. Nixon replied that he had endorsed the notes at the request of Dresser, President of the Trust Company, in order to enable the Trust Company to carry through the promotion. He could not, therefore, accept any personal responsibility. In order to relieve the Trust Company of its burden, a syndicate was formed [2] to pay the $4,000,000 loaned to Dresser on the credit of the Trust Company. In consideration of his release, Nixon assigned to the Trust Company of the Republic the promotion securities, which were to go to Young and his associates.[3] The Sheldon syndicate bought the bonds of the Trust Company for 75% of their par value.[4] Considerable blocks of stock were acquired, at the same time, as bonus.[5]

[1] Conklin's testimony, p. 889.

[2] Syndicate formed by Charles W. Wetmore, with H. L. Satterlee, of the Executive Committee of the Trust Company of the Republic, and George R. Sheldon, of the North American Company. A list of alleged subscribers, with amounts, is given in *New York Tribune*, December 10, 1903. I have no way of determining the accuracy of the *Tribune's* list.

[3] Nixon held a power of attorney and bill of sale from Young. This transaction was subsequently in dispute. Nixon was recommended to make the assignment by Mr. Deming, of Alexander and Green who held, apparently, the papers of Young. (Conklin's testimony (Nixon), p. 891. Dispute referred to in 76 *Chron.* 1412.)

[4] According to the syndicate agreement, the subscribers agreed to furnish $4,125,000 cash. In return, the Trust Company of the Republic turned over to the syndicate managers $5,500,000 bonds, $2,750,000 preferred and $5,500,000 common stock. The managers had until January 29, 1904 to sell the securities.

Report of Dresser to Stockholders of Trust Company of Republic (quoted in full, 76 *Chron.* 191) stated that the profits were to be shared by the Trust Company of the Republic and the syndicate.

[5] The motives that led many prominent financiers to subscribe to this syndicate have been variously defined. Some have gone so far as to say that the syndicate was created solely to relieve the financial tension, and prevent the loosening of

In the meantime, the most optimistic reports of the Shipbuilding Company's earnings were circulated in the Wall Street district. The report to the Stock Exchange, already alluded to, shows total net earnings for the three months ending November 30, 1902 to be over $1,100,000. Of this amount, the shipyards earned over $500,000 and the Bethelehem Steel Company over $600,000. The interest on the bonds for the quarter amounted to less than $400,000. It seemed as though the fixed charges had been earned three times over.[1]

The underlying conditions of the Company's position were not as satisfactory as this report would lead one to infer. The first difficulty was the lack of working capital. All the separate yards had been leased back to the old operators, in the belief that they could be managed more economically by the small corporations.[2] The United States Shipbuilding Company would, according to this plan, derive its income from the dividends on the stocks of the subsidiary corporations. It was recognized that the yards should be helped during the critical periods by advances of working capital, and hardly had the new Company taken over the subsidiary yards than demands began to pour in upon it for advances. On paper, the United States Shipbuilding Company appeared to have upwards of $3,000,000 of working capital. Yet the yards themselves, which the prospectus of June 14th says were to be acquired "free from

confidence that would surely follow the failure of the Trust Company of the Republic, and the disclosure of its cause. In all probability, this was not the main motive. It was rumored through the financial district that the Trust Company of the Republic was in trouble, and that a syndicate was forming to advance the Company money. Incidentally, it was suggested that considerable profit would arise, as the syndicate could purchase the shipbuilding securities of the Trust Company at a low figure. The members of the syndicate believed in the shipbuilding securities, and it was their own auditors that brought to light the errors in the estimates of the previous accountants.

[1]

Earnings shipbuilding yards	$554,021.45
Bethlehem	609,000.77
Total net earnings	$1,163,022.22
Accrued interest and sinking fund payment, quarter	391,666.67

(Listing Application A-2726, December 24, 1902, p. 4.)

[2] The lease system was a device of President Scott of the Union Iron Works.

any liens," had debts of over $2,000,000,[1] some of which were being pressed for payment. As a result of this condition,[2] the parent company paid over to the operating yards, during the first eleven months, over $1,000,000.[3] Of this amount, $60,000 was returned in earnings.

A most unfortunate discovery was made in regard to the Union Iron Works. Instead of having over $1,000,000 of surplus, largely as working capital, which President Nixon was given to understand the yard possessed, it showed instead a deficit of something like $1,400,000.[4] More than that, certain facts that were connected with the management of the Union

[1] $2,334,988. (Auditors' report quoted in Report of Receiver Smith, p. 40.)

[2] "It must not be thought that the United States Shipbuilding Company elements were the only ones to have trouble. Woeff and Zwicker of the West Coast, Trigg Shipyard of Richmond, Va., Townsend and Downey of New York, Neafie and Levy of Philadelphia, and in fact yards all over the country got into difficulties. Cramp after building vessels aggregating nearly $30,000,000 had to be reorganized. The Roach Yard and the Ramsay Yards were closed. Possibly the explanation is that the country was not prepared for the large volume of naval work contracted for in a short time. Yards undertook the most important and difficult work (torpedo boat construction) without experience or organization. Good men were bid for at a premium, and poor men undertook work they could not do." Statement of prominent shipbuilder covering conditions in 1902–03.

"To get an idea of the influence of strikes we may compare the costs of two Monitors.

	Nevada (Bath)	Florida (Nixon)
Materials	$430,043.74	$408,215.07
Labor	318,819.45	372,673.58
Overhead	95,645.81	111,801.90
	$844,509.00	$892,690.55
Contract Price	1,028,393.79	990,573.21
Profit	183,884.00	97,882.26

"Upon analysis it will be seen that the Nixon Yard on the same materials spent $22,000 less than Bath.

"Their labor, however, was $54,000 more. The Nixon Yard was paid $38,000 less for its ship however. The continuous strikes of the two previous years at the Crescent Shipyard increased its labor cost about 17 per cent." Same statement.

[3] August 1, 1902 to July 1, 1903; $1,019,956 in money, and $520,000 of bonds used as collateral for notes of subsidiaries. (Auditors' report, quoted in Report of Receiver Smith, p. 39.)

[4] It should be remembered that the Union Iron Works was the only yard the accounts of which were accepted on the audit of the Company's own accountant. This accountant subsequently was removed to a sanatarium.

Iron Works, not known when the United States Shipbuilding litigation was in progress, show that it was not being managed for the best interests of the holding Company. For example, the payrolls were needlessly increased,[1] expense accounts padded,[2] and unnecessary expenses incurred.[3] Even Receiver Smith, with but a slight acquaintance with the situation at the Union Yard, discovered that the Shipbuilding Company had agreed to retain officials of the Union Iron Works at salaries aggregating $240,000 per year.[4] Ships like the Dakota, California and Milwaukee, which the yard was building, and from which the officers of the United States Shipbuilding Company expected a profit, were being built at a loss, [5] and realizing this, the management of the yard refused to release any of its apparent earnings, to the United States Shipbuilding Company. As President Nixon was spending all the earnings of the other yards in improving their efficiency, he was unable to obtain any dividends or payments from them. The only opportunity for obtaining the requisite money to meet the interest on the bonds of the United States Shipbuilding Company lay in the earnings of the Bethlehem Steel Company. In this direction his hands were tied.

[1] Specific instances.

Salary *before* U. S. Shipbuilding Co. Assumed the Ownership	Salary *after* U. S. Shipbuilding Co. Assumed the Ownership
(1) $27 a month	$3,000 a year
(2) 40 a month	3,000 a year
(3) 200 a month (Cousin of wife of President of Yard)	6,000 a year
(4) Engineer $7,000 a year	$10,000 a year
(5) Three Engineers $7,200 a year	10,000 a year
(6) Five Engineers $300 a month	5,000 a year

(Evidence taken directly from memorandum in handwriting of important official of Union Iron Works.)

[2] "Under the item of expense account are many items not in right place, and so placed to prevent true light on same." (Memorandum quoted in previous note.)

[3] An office in London in charge of a cousin of the President's wife "neither sent any work worthy of the expense, neither has it made any money, but is a loss all the time." (Same evidence as preceding note.)

[4] Report of Receiver Smith, p. 62. The original purchase contract letter, on the basis of which all the yards were transferred to the Shipbuilding Company, shows guaranteed salaries for the Union Iron Works of $56,000 per annum. Minutes of Directors' Meeting, U. S. Shipbuilding Company, June 24, 1902.

[5] Memorandum quoted in previous footnote.

The distress of the shipbuilding yards would not have affected the larger company seriously had the Bethlehem earnings been available. This was the only one of the subsidiaries which was profitable. Although loaded down with fixed charges, the Bethlehem Steel Company was able to show a net profit of over $1,500,000 [1] during the first year. Had the Directors been willing to release some of their earnings to the parent Company, it could have met its interest on the first mortgage bonds. The Board of Directors, who were under the control of Charles M. Schwab, voted instead only $250,000 to the Shipbuilding Company, — just enough to meet the semi-annual interest payment on the Collateral Trust Bonds issued for the purchase of the Bethlehem works. The rest of the earnings were deflected to the purchase of iron mines,[2] to the accumulation of inventoried merchandise, and to the general improvement of the plant.[3]

In the presence of this march of events, President Nixon was powerless. On September 22, 1902, Max Pam, Schwab's attorney, became Chairman of the Board at a salary of $18,000 a year.[4] After that time, the places on the Bethlehem and United States Boards were gradually assumed by Schwab's friends and relatives. The divergence of interests between the Bethlehem and the parent Company was shown by the action of the Executive Committee of the United States Company, which, on April 7, 1903, authorized the Bethlehem Company to enter upon improvements representing an expenditure of $2,800,000.[5] President Nixon's control was more and more confined to the manufacturing side, and even there his freedom of action was seriously restricted.[6] Finally, during May and

[1] Schwab had told Nixon and Dresser that the Bethlehem Company was earning $1,400,000. Receiver Smith, who appeared to be prejudiced against the Bethlehem management, admitted in his report that the Company had earned $1,662,530 in the year from July 31, 1902 to August 1, 1903. This clearly shows that Schwab sold the Bethlehem Company under no false pretentions.

[2] For example, the Company purchased the Juaragua mines for approximately $350,000.

[3] Evidence shows about $683,370 expended on improvements.

[4] Conklin testimony, p. 595. Salary was dated back.

[5] Conklin testimony, p. 604.

[6] Just before Nixon's resignation from the Presidency of the United States Shipbuilding Company, in June, 1903, he prepared bids on two battleships. Pam

June, 1903, he sought at numerous times to secure a quorum of the Board of Directors, in order that some action might be taken. In this he failed. Mr. Schwab told him, according to the latter's testimony, that he had instructed certain members of the Board not to attend the meetings.[1]

The dilemma in which the President found himself was all the more critical because the United States Company was becoming seriously embarrassed. The shipbuilding yards were sapping the life from it through their continual demand for cash advances, while the only subsidiary on a firm paying basis was putting all its earnings into improvements and materials. On July 1, 1903, the Company would have to meet the payment of $900,000, partly interest on bonds and partly further advances to its subsidiaries. There was next to no free capital in the treasury. To make the situation more serious, the Company found itself unable to secure additional capital by hypothecating its own bonds, on account of the low market quotations on its securities.

Meanwhile, the members of the Sheldon Syndicate were not mere passive onlookers. As soon as they had acquired the shipbuilding securities of the Trust Company of the Republic, they set to work to investigate the merits of the enterprise. The reports of their accountants were very unfavorable. It became clear that the earnings had been over-estimated in the original statements, and that the actual working capital had been reduced by the continual advances to the subsidiary yards to a critically low figure. It was absolutely necessary to obtain new money, or else the business of the Company could not be maintained. In this difficulty the Syndicate appealed to Schwab. He had been watching the course of events, and had seen, with considerable disappointment, the declining earnings of the shipbuilding yards. His own Bethlehem plant was the only subsidiary, the operation of which had met the expectation of the promoters.

refused to allow him to submit them, but had Mr. Hanscom, of the Eastern Yard, submit others. Pam's bids were too high. This incident enraged Nixon and he resigned from the Presidency. (Conklin testimony (Nixon), p. 1164.)

[1] Conklin testimony, p. 607.

Under these circumstances, he was unwilling to make further advances in money unless the holders of the first mortgage bonds, — those secured by a lien on the yards, — would consent to a considerable sacrifice.

Toward the end of March, 1903, rumors of a reorganization were circulated. President Nixon was quoted as saying that plans were being discussed for obtaining capital, in order that the Company might "take care of the volume of work which now seems assured." [1] The leading members of the old Sheldon Syndicate constituted themselves a Reorganization Committee.[2] Their attorneys, Sullivan and Cromwell, coöperated with Max Pam, as Schwab's representative, and finally worked out a plan of reorganization, the full details of which were published about May 25. The terms of this plan forthwith became a storm center. The plan involved, in brief, the creation of three kinds of securities, — bonds, preferred, and common stocks. Schwab was to pay $2,000,000 in cash, and receive new bonds for his cash, and his old Bethlehem Collateral Trust Bonds. This was the pivot around which the whole plan turned.[3] The holders of the shipyard bonds were to pay no assessment, but were asked to take new preferred stock, with a 20% bonus of common stock. The old shipbuilding stocks were to be exchanged into common stock.[4] For the details of the plan, see the table opposite page 507. It involved the placing of Schwab's lien ahead of the lien on the yards, and upon this feature most of the

[1] 76 *Chron.* 977. Nixon felt assured of a large Japanese contract.

[2] George R. Sheldon, Chairman, Charles S. Fairchild, John E. Borne, Max Pam, and Charles W. Wetmore.

[3] Nixon testifies that Schwab early (April) made up his mind that "the Bethlehem bonds should become the first mortgage bonds on the shipbuilding properties, as a condition that he would advance certain moneys; that was the condition and the whole plan was moulded about it." (Conklin testimony (Nixon), p. 625.)

[4] Reduced to the terms offered to the holders of the securities, the plan worked out as follows: —

		New Securities		
Old Securities	Assessment	Bonds	Preferred Stock	Common Stock
Shipbuilding First Mortgage Bonds	..	..	$100	$20
Bethlehem Collateral Trust Bonds	$20	$120	15	16
Preferred Stock	..	..	..	40
Common Stock	..	..	..	10

criticism of the plan was directed. Aside from questions of fairness, it was conservative. The old bonds, both series, carried annual interest payments of $1,225,000.[1] This plan, had it been consummated, would have reduced the interest charges to $500,000, not including the interest on the new money advanced by Schwab. The President of the Bethlehem and Treasurer of the Shipbuilding Company estimated the current earnings of all the plants at $3,000,000,[2] after deducting the charges on the underlying Bethlehem bonds.

Looked at broadly, the plan seemed to favor the bonds held by Schwab. The old shipbuilding bonds were secured by a first mortgage on the yards; yet they were asked to take a position junior to the Schwab bonds, which were secured only by Bethlehem stock ahead of which were over $8,000,000[3] underlying bonds. Moreover, it appeared, even on the statement of the treasurer of the Shipbuilding Company, that the earnings of the yards would be sufficient to meet the interest on the first mortgage bonds issued against them.[4] On the other hand, the Company was then in a critical position. There were outstanding floating debts of over $3,000,000[5] and new capital had to be provided. The President and the Treasurer had exhausted every source at their disposal for raising additional funds. No means seemed available.[6] The Company faced immediate bankruptcy, and in this emergency, Schwab stood ready to advance $2,000,000. He could well contend that the Bethlehem plant, although burdened by heavy underlying liens, was the only subsidiary possessing a liberal earning power. It was very clear that the Bethlehem could do without the shipbuilding yards, but they could not do without the Bethlehem, and under these circumstances Schwab sought to drive as hard

[1] Not including interest on bonds in treasury, nor underlying bonds of Bethlehem Steel Company.

[2] Plan and Agreement of Reorganization, May 25, 1903, p. F.

[3] Bethlehem Iron Co. $1,351,000
Bethlehem Steel Co. 7,500,000

[4] Estimated earnings shipbuilding plants per annum, $750,000. Fixed charges on $14,500,000 outstanding, $725,000.

[5] $3,335,264. Plan of Reorganization. May 25, 1903, p. 2.

[6] Conklin testimony (Nixon), p. 623.

a bargain as its fortified position allowed.[1] These same reflections were in the mind of Nixon, for he wrote Max Pam, on May 17, that "after careful study and conference, I cannot see my way clear to approve of the plan,"[2] but as no other means of obtaining working capital appeared available, he finally consented in a letter written May 26, 1903.[3]

On June 4, an advertisement in the daily New York papers advised the holders of the bonds on the shipbuilding yaıds to withhold their consent to the Sheldon Reorganization Committee's plan. At the same time, the author of the advertisement had printed a circular which pointed out the striking discrepancies between the statements in the Public Prospectus of June 14, 1902, and the circular of the Reorganization Committee. In the former, the earnings of the yards were stated to be $2,225,000; in the latter, $750,000.[4] The circular suggested, "The Company needs a searching examination into its affairs by a fearless committee." It is true that the examination that followed was searching enough; whether the persons conducting it were fearless and impartial is another question. The opposition movement was taken up by a group of men, headed by Roland R. Conklin, who, on June 11, applied to the United States Circuit Court at Trenton for the appointment of a receiver, and an order restraining the Company from carrying out the reorganization. They employed Samuel Untermyer as council, and prepared to enter upon extended litigation in order to obtain better terms for the holders of the shipbuilding first mortgage bonds.

[1] Schwab gave out to the press, when the terms of the reorganization were subject to discussion, that he owned $850,000 of the bonds on the shipbuilding plants. He later admitted that this was false, and that he owned only $250,000. (Conklin testimony (Schwab), p. 2202.)

[2] Conklin's testimony, p. 633.

[3] The testimony in the Conklin case brings out a correspondence between Schwab and Joseph H. Hoadley, relative to taking over Nixon's bonds (p. 1103). It had no basis.

[4] Printed circular of Gustave Loeb, June 4, 1903, section 11. Loeb's interest in the bonds was small. It has been remarked in other connections that there are always men who stand ready to give advice and to plead the cause of the innocent and injured security holder.

Before this, the disagreement of Schwab and Nixon reached a breaking point, and the latter resigned as President of the United States Shipbuilding Company. Both published extended statements in the New York papers. Nixon alleged that the Shipbuilding Company had been brought to the brink of bankruptcy by the action of Schwab, while the latter defended his course in protecting the Bethlehem as both honest and conservative. He offered to surrender his shipbuilding bonds and stocks, and receive back the Bethlehem stock, but the proposition was not taken seriously. From this time on, the public press was used by both sides to exploit the "shipbuilding scandal" as it was called. Unfortunately, much that was said on both sides was untrue. Mr. Untermyer, as counsel for the Conklin protestants, did all that he could to exaggerate the fraudulent character of the enterprise and aggravate the already intense ill-feeling. He hoped, by turning the episode into a public scandal, to bring the pressure of public opinion to bear upon Schwab and the Sheldon Committee, so that they would feel themselves compelled to modify the original plan of reorganization. Unfortunately the public press and the courts lent themselves all too readily to these tactics. Every corner of the promotion was searched for the discreditable and the fraudulent, to keep alive the fire of public disgust. Even private cablegrams, very humorous in their character, but in no wise pertinent to the real issue, were brought into evidence and exploited in the press.

Meanwhile, Judge Andrew Kirkpatrick chose James Smith, Jr., of Newark, a former United States Senator, as receiver.[1] Smith worked in opposition to the Sheldon Committee, the interests of which, as holders of large blocks of the shipbuilding bonds, were identical with those of the complainants, — Conk-

[1] This appointment was as unfortunate as the rest of this unfortunate history. Judge Kirkpatrick had been raised to prominence through the political influence of Mr. Smith, who was popularly known as a "political boss." The receivership of a large corporation, with the heavy fees, was regarded, to use popular parlance, as a "plum." It was stated in the Wall Street district, long before the receiver was appointed, that, "if a receiver for the shipbuilding is appointed, Smith will be the man."

lin, and the Bondholders' Protective Committee, whose cause he espoused. The Mercantile Trust Company and the New York Security and Trust Company, as trustees for the original bonds, brought foreclosure suits in order to hasten the work of the Sheldon Reorganization Committee. All these actions were later consolidated, but into this legal quarrel it is not necessary to enter.[1] On October 31, 1903, Receiver Smith filed his report. The document is unusual of its class, and would deserve more of our attention were its tone less biased. It is some ninety pages in length, and gives an outline of the promotion and subsequent history of the Shipbuilding Company. It quotes at length the famous letter of Young to the first dummy stockholders, offering to convey the shipbuilding yards to the Company; and it gives a brief epitome of the reports of the New York Audit Company on the businesses of the separate yards during the first year of the Shipbuilding Company's history. But besides this material, the report is of little value. It was largely the work of Samuel Untermyer, written primarily to fan the already kindling flame of public indignation, and to give form and substance to the allegation that Schwab caused the failure of the shipbuilding enterprise.[2]

During the winter of 1903–04, testimony was taken before a master in the Conklin suit, and this testimony, reprinted with editorial comment in the press, added still more to the notoriety

[1] A number of suits arose out of the case, the plaintiffs of which were public holders of these securities. The Mercantile Trust Company and Alvin Krech were the defendants. The plaintiffs claimed that they had been defrauded. Apparently they had bought the shipbuilding securities as a speculation, — shown clearly by the prices they paid, — and when the enterprise failed, tried to throw the responsibility on to other shoulders. Instead of bringing suit against the real promoters of the Company, they sought to connect parties of assured financial responsibility. See especially Kavanaugh *v.* Mercantile Trust Company *et al.* The plaintiff operated a Knitting Mill at Waterford, Saratoga County. He purchased $50,000 of bonds, 200 shares of the preferred stock and 500 shares of common stock.

[2] It is unfortunate that this polemical report, issued under the mantle of the courts for a covert purpose, should have received the publicity it did. Even to this day it is regarded as an authentic account of the Shipbuilding Company, as is shown by the fact that Professor William Z. Ripley reprinted it in his *Trusts, Pools and Corporations*.

of the Shipbuilding Company, its promoters and Charles M. Schwab in particular. The tension became so great at last, that efforts were made by both sides to effect a compromise.[1] Meanwhile, the shipbuilding bonds had declined to 18%[2] and all concerned realized that the sooner the notoriety of the proceedings had subsided, the better it would be for the financial world in general, and the shipbuilding enterprise in particular.

The members of the Sheldon Committee had succeeded in obtaining deposits of approximately $22,000,000 out of some $24,000,000 of outstanding bonds, so that they were in a position to push through their plan, had they so determined. At this point, it was decided to compromise the issue. In a letter to Chairman Sheldon of the Reorganization Committee,[3] alleged to have been written January 25, 1904, Smith states that he has "for some time past been considering a modification of the plan of reorganization of the United States Shipbuilding Company, which would be likely to be acceptable to both classes of bondholders, and would tend to prevent the sacrifice and waste of the assets which will necessarily result from further and protracted litigation. After carefully considering the relative value —I have formulated a plan of reorganization, an outline of which I submit to you herewith." In reality, the plan was arranged by Sullivan and Cromwell and was called the "modified plan."

The new proposal was fundamentally different from the first. Both the Bethlehem collateral trust and the shipbuilding first mortgage bonds were to be exchanged for stock, the old stockholders were to receive nothing, and the only bonds placed on the properties were to be given for actual money. In a measure both sides made sacrifices. Schwab gave up the demand that he should be made a preferred creditor, and the Sheldon Committee gave up any claim to new securities, in

[1] 78 *Chron.* 291, January 23, 1904.

[2] Sale of $230,000 at auction on December 30, 1903, 78 *Chron.* 51, January 1, 1904.

[3] Reorganization Committee Circular of February 4, 1904, p. 1. It was thought expedient to have it appear that the new plan emanated from Smith, so that the first mortgage bondholders, whom he was thought to represent, would be more willing to accept the plan.

place of their heavy holdings of old preferred and common stocks. These had declined to a few cents in value. The few public investors, who had acquired the bonds originally for money, were most fairly treated. The table on the following page affords an opportunity to compare the original capitalization of the United States Shipbuilding Company and that proposed in the two plans of reorganization. In addition to the exchange of securities indicated by the table, it was provided that the holders of the shipbuilding bonds should be allowed to subscribe for $1,500,000 of new 6% ten-year bonds, at 87½%; and the holders of the Bethlehem collateral trust bonds were tendered the same privilege. An underwriting syndicate[1] was formed to take care of the $3,000,000 of new bonds, in case the old security holders did not avail themselves of the subscription. Considering that this obligation was the only lien on the Bethlehem stock and the other property, and that the bonds could be bought on an 8% basis, the subscription privilege must be regarded as a valuable one.[2]

This final plan was most conservative. The bonds and fixed charges were wiped out, and the only lien left was represented by actual money subscriptions. Moreover, the net capitalization, not including the underlying Bethlehem bonds and the new bonds issued for these subscriptions, was reduced from $69,500,000 to $30,000,000. All of the new capitalization was in stock, bearing no fixed charges. Besides, the plan was remarkable for a reorganization so drastic in the fact that all the merchandise creditors were paid in full from the treasury of the new Company.

Practically no opposition arose to the consummation of the reorganization, and in due course of time, the two old mortgages

[1] Morton Trust Company and Thomas F. Ryan, syndicate managers. See syndicate agreement, dated January 27, 1904.

[2] The individual allotments according to this plan can be seen at a glance from a table: —

Each Holder of $1,000 in Bonds,	would be allowed to subscribe, at 87½%	and would receive New Preferred Stock	New Common Stock
Shipbuilding Bonds	$100	$400	$600
Bethlehem Collateral Trust Bonds	$150	$900	$600

were foreclosed, and the property bought in by representatives of the Reorganization Committee. Late in December, 1904, the Bethlehem Steel Corporation was incorporated, and presently took over the physical assets of the old United States Shipbuilding Company which passed out of existence.

The failure and reorganization of the United States Shipbuilding Company offers some unusual features. Had the Company been organized along the lines first planned, with preferred stock and common stock, but with no bonds, it probably would not have failed. If, too, it had acquired the Bethlehem works with money or stock or even bonds so issued as to insure the maintenance of control, it probably would not have failed. Nor would it have failed if the management of the Bethlehem Steel Company had been willing to assist the Shipbuilding Company. Nor would it have failed if the suspension of the French underwriting had not prematurely and permanently destroyed the Company's credit. Nor would it have failed if the net surplus and working capital of the Union Iron Works had turned out to be as originally represented, so that its earnings could be used to tide over the crisis. Aside from the stupid and unnecessary bungling in the promotion of the Company, a feature in the whole situation more picturesque than vital, the Company began its existence in no worse condition than numerous other combinations promoted during the four preceding years. It was not as extravagantly capitalized as the United States Steel Corporation promoted a few months before, nor the International Mercantile Marine, promoted at the same time, — both under the strongest auspices. Its chief reason of failure lay in the fact that shipbuilding, never particularly profitable, was at the time particularly unprofitable. This, combined with the load of bond debt, the obstinacy of the Bethlehem management, and finally the notoriety attracted to the Company precipitated its downfall before it had hardly started on an independent career.

In spite of the criticism directed against it, the first plan of reorganization, although in no sense conservative, was eminently fair to all the interests concerned. In the brief period of opera-

tion, the Bethlehem works showed a larger profit than had been anticipated; the shipbuilding yards, supposedly the nucleus of the consolidation, showed far less than anticipated. From the point of view of earning capacity, therefore, the holders of the Bethlehem bonds were in a distinctly stronger position than the holders of the bonds on the shipbuilding yards, and it was natural that they should demand a superior lien. The second plan, although not so fair to the holders of the Bethlehem bonds, was far more conservative. It contemplated the retirement of all the bonds, and the absolute cancellation of all the stocks. New bonds were issued merely to fund the new money actually contributed. In a very real sense, therefore, the reorganization was one of the most drastic to be met with in recent financial history. And this fact is the more remarkable, when it is remembered that one of the subsidiary companies was in profitable operation, and that the aggregate net earnings of the subsidiary plants were ample to meet all the interest charges, had they been available. In a true sense, the reorganization was merely a second step in the promotion.

CHAPTER XIX

THE AMERICAN GLUE COMPANY[1]

Historical account of the Glue industry, 511; promotion of the American Glue Company, 511; dissension in the management, 513; formation of the Glue Corporation, 514; settlement of internal friction, 516; formation of the Massachusetts Corporation, 517; summary, 517.

CHRONOLOGICAL SUMMARY

1894. Formation of American Glue Company.
1902. Attempt to form Glue Corporation.
1906. Incorporation of Massachusetts Corporation.

GLUE is a by-product manufactured from the refuse of tanneries and slaughter houses. It is extensively used in the cabinet making and wood-working industries, and to some extent in the manufacture of sandpaper and abrasing materials. Some competition has always existed in the industry, because of the widely different sources of material, and the relatively small amount of capital required to start and operate a small glue plant. The history of the American Glue Company was selected to illustrate a reorganization that turned upon a feud among the managers of the enterprise. It is the single case of corporate reorganization thus far described that turns on personal rather than financial motives. For this reason, it has seemed necessary to describe some of the circumstances connected with the promotion of the Company, but because of the personal motives upon which the reorganization turned, it has seemed wise to omit specific mention of names.

[1] This brief account of the attempted reorganization of the American Glue Company and the attendent circumstances is inserted at the end of the separate historical studies, in order to show an example of a reorganization brought about by dissension in the management. It has little bearing on the previous studies, which dealt with causes leading to failure and the reorganization following. The American Glue Company's reorganization was resorted to in order to remedy an intolerable situation in the management.

The earliest established business entering into the American Glue Company consolidation was founded by Elijah Upton, at Peabody, then South Danvers, Massachusetts, in 1808. Gradually the business developed under the administration of his descendants until by 1894, it had control of several independent glue plants in Pennsylvania and Illinois. At that time, in the presence of the money stringency, it seemed expedient to consolidate the plants with a large glue selling house. Accordingly, the American Glue Company was formed July 7, 1894, and acquired, for $650,000 in 8% preferred stock, and the same amount in common stock, five glue plants of considerable size together with a large independent selling company.[1] The preferred stock alone had voting power, because the transfer of property took place on the belief that the American Glue Company was issuing preferred stock in exchange for money and conservatively valued tangible assets. This was entirely correct. There seems no doubt that the property acquired by the Company was worth at least the original issue of preferred stock, $650,000. It was known to all parties, as shown by the signed agreement of June 16, 1894, that the common stock was issued for good-will and similar intangible assets.[2] In the course of time, in order to acquire the N. Ward Company and the Dow Company, dealers in glue materials, the preferred stock was increased to $1,000,000, the most of which was sold to outside interests for money. At all times, after the Company commenced

[1] The details of the transaction were as follows: —

		For which were issued	
	Cash	Preferred	Common
Selling Company	$100,000	$100,000	$100,000
Peabody Plant	200,000	200,000	200,000
Peabody Merchandise and Accounts	150,000	150,000	150,000
Springdale, Boquet, and Allegheny Factories of the Pennsylvania Glue Company	150,000	150,000	150,000
Chicago Factory, Illinois Glue Company	50,000	50,000	50,000
		$650,000	$650,000

Details from signed agreement of June 16, 1894.

[2] The amount of the common was subsequently increased to $800,000.

business, the tangible assets were worth well over the outstanding preferred stock.[1]

Turning now from the financial affairs of the Company to its administration, certain elements in its organization should be noted. Although the Vice-President controlled a clear majority of the stock, all interests agreed on the expediency of placing the financial and administrative control in the hands of the President. Accordingly, an agreement was signed "to place in the hands of Trustees,[2] to be named by the President, two thousand, five hundred and forty-four shares of said preferred stock upon the trust, that in the election of the Directors and Officers of said Company, and upon other matters arising at stockholders' meetings, said Trustees shall vote thereon as requested by said President."[3] Together with the preferred stock owned and controlled by the President, this gave him the control of the Company. In accordance with this agreement, the President elected four of the Board, the Vice-President three, and the eighth was the resident New Jersey director. Various changes of minor importance occurred during the next seven years of the Company's history. For our purpose, however, we need only note that the original agreement was renewed so that although the Vice-President continued to control more stock than the President, the control of the Company was vested in the President and his nominees. He had the direction of the Company's financial affairs and managed them well, so that the general credit of the Company improved, the common stock, originally issued for intangible assets, assumed a sub-

[1] Earliest published balance sheet. May 31, 1894.

Assets			
Real Estate	$282,269	Stock, Preferred	$1,000,000
Treasury Stock	22,300	Stock, Common	800,000
Cash and Receivables	425,458	Debts	621,108
Materials	838,744	Profit and Loss	256,130
Patents	800,000		
Miscellaneous	308,467		
	$2,677,238		$2,677,238

70 *Chron.* 684.

[2] Massachusetts Loan and Trust Company of Boston.

[3] Agreement of June 16, 1894. This trust was to be terminated after five years provided certain notes to the amount of $50,000 were paid.

stantial value, and the preferred stock approached the status of an investment security.

Part of the success, at least, of the American Glue Company was due to the conservative policy of the Directors, as controlled by the President. Although the corporation made a profit constantly, and the smaller businesses it had absorbed were paying handsomely, no dividends were declared on the common stock. This was particularly objectionable to the Vice-President, who owned or controlled upwards of 7,400 shares of which approximately 4,600 were common stock. The continued reluctance on the part of the Board to declare common stock dividends seemed unnecessary. He tried to persuade the President to relax his conservatism, and even threatened to sue the Company for dividends illegally withheld. The matter of dividend policy was not the only cause of friction between the President and the Vice-President. It was the opinion of the former that his associate did not devote enough time to the business and that he had too many outside interests to enable him to give to the American Glue Company the undivided loyalty his position in the Company demanded. The Vice-President was a director in a competing glue concern, in a thermometer company, and in a bank. As he had charge of the manufacturing side of the business, it was natural that any failure of the factories to attain to a high state of efficiency should be attributed by the President to inattention on his part. Furthermore, numerous smaller matters were the occasions for continued friction, and though not in themselves sufficient to have produced an outward break, altogether tended to aggravate any more deep-seated motives for discord.[1]

The trouble, long brewing, as is shown by successive signed agreements in which the difficulties were from time to time smoothed over, came finally to a head in the spring of 1902. The Vice-President of the Company was particularly desirous

[1] One of these arose over the fact that the Vice-President was accused of blocking at the last moment, the so-called "Steinfeld" deal. This was a consolidation of the American Glue Company and various packing house glue companies proposed by prominent New York attorneys.

that the Directors should declare a dividend on the common stock. He therefore induced one of the members of the Board nominated by the President to vote for an initial dividend. He also obtained the presence at the meeting of the resident New Jersey member. This gave him a majority of one, and the dividend on the common stock was declared. From the decision of this meeting, it was clear that the control of the Company, originally vested in the President through the trust agreements, was gone. Some new methods must be taken to insure its continuation. Accordingly, Mr. George Wickersham of New York was consulted by interests associated with the President. He advised the formation of a holding Company, all the stock of which should be placed in the hands of voting trustees. This plan was adopted, but for its success it must be put in operation before the Vice-President became aware of it, else the management and the whole administration of the Company would become disorganized. Accordingly, a charter from New Jersey was obtained for "the Glue Corporation." Its capital stock was \$6,000,000, — \$2,000,000 4% cumulative preferred stock, and \$4,000,000 common stock. An agreement was drawn up, dated September 27, 1902, for the exchange of American Glue Company's stock and voting trust certificates for the securities of the Glue Corporation on the following basis: For every one share of American Glue Company preferred stock was to be given one share of new preferred and one share of new common stock. For every two shares of American Glue common stock was to be given one share of new preferred and one of new common stock. In other words, the preferred was given a valuation just twice that of the common.

American Glue Company		The Glue Company	
		New Preferred	New Common
Old Preferred	\$1,304,300	\$1,304,300	\$1,304,300
Old Common	790,200	395,100	395,100
To be Issued for Entire Stock of the American Glue Company ..		\$1,699,400	\$1,699,400
Remainder in Treasury for the Extension of the Business		300,600	2,300,600
Total		\$2,000,000	\$4,000,000

Those associated with the President had been able to secure the deposit of approximately 55% of the total outstanding stock of the American Glue Company, and its exchange into the Glue Corporation's securities before the Vice-President of the Company was aware of the intended reorganization. He discovered the plan only by accident, learning of it from an old schoolmate who had been asked to deposit his stock. This was early in November, 1902, and he immediately secured counsel and prepared to contest the reorganization. On November 4, 1902, he applied to the court for authority to obtain access to the list of the shareholders, and sent out a circular letter stating that the proposed reorganization was merely a covert attempt to eliminate his interests from the American Glue Company, and to perpetuate the President's control by means of a voting trust. All stockholders were invited to attend an informal meeting to consider the subject to be held November 8, in Tremont Temple, Boston.

Meanwhile, the entire subject was discussed in the Boston financial papers. It was pointed out in an article in the *Boston News Bureau*, inspired by the Vice-President's side of the controversy,[1] that the stockholders would not benefit by the exchange, as the new Corporation would be entirely dependent on the dividends of the American Glue Company for its revenue. This the other faction denied, as it was the intention of the management to use the treasury stock to extend further the business. It was further contended that the reorganization was illegal under the New Jersey laws. This was probably not true, as Mr. Wickersham would hardly have proposed the reorganization, if it could not have been consummated legally. At all events, a good deal of feeling was excited on both sides, and at the stockholders' meeting each party was accused by the other of unfair practices and malicious motives. Practically no stock was withdrawn from the Glue Corporation, so that the new Company still held the majority of the stock and, therefore, the actual

[1] Most of the comments in the papers failed to get at the facts in their true setting as they were inspired by one side of the controversy only. This observation is particularly true regarding the items in the *Boston News Bureau.*

control of the American Glue Company. This was in spite of the large interests of the Vice-President.

Soon after the informal stockholders' meeting at Tremont Temple, a meeting of the interested parties took place at the office of the American Glue Company. Both sides were represented. In the course of the negotiations, it was proposed that one party should buy out the interests of the other, and thereby eliminate the cause of friction. At the time the American Glue Company was organized, eight years before, it had been the intention of the President to withdraw as soon as the Company was well established. His salary contract was originally drawn so that the Company would buy from him, each year, $10,000 par value, of its stock. This had not been enforced, but largely because of advancing years, he now chose to dispose of his holding. Accordingly a syndicate was formed which subscribed $500,000 and took over the interests of the President at $120 a share for the preferred stock and $60 a share for the common stock. These quotations were slightly less than the prevailing market values. The same offer was extended to other stockholders of the American Glue Company who had exchanged their shares for those of the Glue Corporation, but it was previously arranged that some of the Glue Corporation stock should not be acquired by the syndicate, for the amount of its subscriptions did not enable its managers to acquire the entire stock deposited under the plan of reorganization. Subsequently, all the Glue Corporation stock issued under the agreement of exchange was turned back into the shares of the American Glue Company, and gradually the holdings of the purchasing syndicate were distributed among small investors, till the number of stockholders rose from two hundred to seven hundred.

The majority of the investors in the American Glue Company were residents of Massachusetts. They were for the time seriously affected by the fact that the Company was incorporated under New Jersey laws, which compelled them to pay a Massachusetts tax. Especially burdensome did this appear, because a large part of the Company's real estate was in Massachusetts, and its stockholders were, therefore, in truth compelled

to pay a double tax. Some of these small stockholders and a few Massachusetts trustees holding shares of the stock suggested that the Company be reincorporated in Massachusetts, for in this way they could avoid the double taxation. The plan met with very little attention, and was soon abandoned. During 1905, the plan of a Massachusetts corporation began to receive considerable attention especially as the stock had attained, in the meantime, an even greater distribution among small investors. By January 6, 1906, the plan had been widely discussed, and it was publicly announced that the proposition would be voted upon at the annual stockholders' meeting of January 16. On that date the sentiment was overwhelmingly in favor of the plan, and it was voted to give up the New Jersey charter, and transfer the assets of the Company to a new Massachusetts corporation of the same name and with the same capitalization. Papers were filed for the Massachusetts incorporation immediately, and the transfer was soon accomplished.

In this summary history of the American Glue Company, two features are of interest — the attempted reorganization in 1902, and the reincorporation in Massachusetts. The attempted reorganization in 1902 is of interest as an instance, in our American finance, of the disastrous effect of a personal quarrel among the officers of a large corporation. Ordinarily competitors of years have united their interests in a large consolidation, and have conducted its affairs in personal harmony with each other. But in the case of the Glue Consolidation differences of policy among the administrative officers were sufficient to create an intolerable situation, which ultimately threatened to rend the organization of the Company in two. In the case of the reorganization under Massachusetts laws, one is presented with an instance of merely a legal change of charter. The business of the Company was in no wise affected. The whole purpose was to avoid double taxation among a large part of the Corporation's stockholders, and the reorganization turned solely upon compliance with certain statutory requirements.

CHAPTER XX

THE PROMOTION OF CONSOLIDATIONS THAT HAVE UNDERGONE REORGANIZATION

1. Stages in the Formation of an Industrial Consolidation.
2. Time of Consolidation.
3. Character of Promotions.
4. Purposes of Consolidation.
5. Prospective Profits on the Basis of Past Earnings.
6. Assets and Capitalization at Time of Promotion.
7. Form of Securities issued at Time of Promotion.
8. Promoter's Profits.
9. Lasting Influence of the Promotion Period.

1. *Stages in Formation of an Industrial Consolidation*

THE purpose of the present chapter is to summarize the facts and conditions developed in the previous studies that pertain to the promotion period of the corporations discussed. The immediate object is to ascertain whether or not there were elements in the methods or practices of the promotions which contained the conditions of the subsequent failure. The inquiry may be put in the form of a question — were the failures directly due to certain characteristics of the promotions?

Competition was invariably the immediate cause which led the competitors in an industry to enter into any form of coöperation or negotiation with each other. This coöperation appeared in four distinct stages, and many industrial consolidations passed through all four.[1]

The simplest and most elementary form of industrial coöperation was the *gentlemen's agreement.* The manufacturers met together infrequently or at regular intervals and discussed what prices "ought to be." The meeting usually ended with a tacit understanding that all the manufacturers would maintain prices

[1] The only consolidation previously discussed which represented all four stages, was that of the cordage industry, p. 112.

at these levels, but no written agreements were ordinarily entered into because of the impossibility of enforcing them, even under the common law. Sometimes the price understandings were reinforced by a definite agreement to curtail production,[1] but such supplementary arrangements were not necessarily involved in any agreement covering the maintenance of price. A good outline of the successive forms of gentlemen's agreements is suggested by J. W. Jenks in his outline of the early whiskey pooling agreements[2] or in the outline of the history of the cordage industry by Clark.[3] With regard to the consolidations discussed in the first part of this book, eight[4] out of the fourteen were preceded by some form of gentlemen's agreement regarding prices.

The second stage was a *pool*. The difference between a gentlemen's agreement and a pool is that the latter always involved a paying in and drawing out clause. Finding that one or more of the parties to the first form of gentlemen's agreement always broke the agreement, in spirit if not in letter,[5] the manufacturers who intended to live up to their compact insisted that some forfeit be established so that what could not be enforced in law should be maintained from motives of pecuniary expediency.[6] This was accomplished by penalizing over-production. The outputs of all the manufacturers were agreed upon among themselves according to the existing capacities of their factories. The total probable sales at remunerative prices were then apportioned in accordance with the capacities of the various plants. Each manufacturer was permitted to increase his output beyond the allotment, but in that case he paid into the pool or common treasury a certain amount per unit of product, — for example a

[1] United States Leather Company, *supra*, p. 16.

[2] IV *P. S. Q.* 296.

[3] Digest, *supra*. Reprinted in full, Dewing, *The National Cordage Company*, Harvard University Press.

[4] The United States Leather, the Glucose Sugar Refining, the National Cordage, the National Salt, the American Malting, the Mt. Vernon-Woodberry, the New England Cotton Yarn and the United States Shipbuilding Companies.

[5] *Supra*, p. 76.

[6] *Supra*, p. 114.

half a cent a pound on binder twine or glucose, — which was believed to represent the net profit. The manufacturer whose output fell below the allotment drew out the same amount for each unit of the difference between his actual sales and his allotted sales. Generally there was an auditor who examined the books of the members of the pool to prevent deceptions.[1] Such deceptions would, however, occur in spite of the utmost precautions[2] and the stronger members would insist on a reallotment when it became clear that they continuously paid in, so that the individual pool always proved short-lived although a succession of pools, under varying agreements, might continue for a long period of time.[3]

The third stage was the *legal trust*. Conditions of law and policy were changed after 1890, so that none of the industrial consolidations promoted after that time passed through this stage.[4] In effect the trust form of consolidation arose as a safeguard against the deception and misrepresentation of the pool form of organization, just as the pool arose as the means of making more binding the looser gentlemen's agreement. The

[1] See *supra*, pp. 114 and 76 (cordage and glucose) for detailed descriptions of two pools.

[2] *Supra*, p. 75.

[3] Presumably the steel industry has seen the largest development of the pools, both in extent and length of operation. See also note *supra*, p. 115.

[4] It has been maintained that the disappearance of the legal trust from all states except Massachusetts has been due to the fear of the so-called Sherman Act of 1890. This is entirely wrong. In 1890, the state of New Jersey spread on its statute books the general corporation law of that year, to replace the older Corporation Act of 1875. The Act of 1890 permitted one corporation to hold the stock of another. Subsequently, in 1890 and 1892, the state courts of New York and Ohio handed down decisions involving the forfeiture of the charter of a corporation entering into a trust agreement such as then was exemplified by the American Sugar and Standard Oil trusts. At this point the legal advisers of the trust officers advised them to relinquish the trust form of organization, and incorporate a holding company under the New Jersey statute which should take absolute legal title to the property or stock of the constituent companies. Such a holding company, under the protection of the New Jersey statute, possessed all the advantages and none of the possible legal complications of the trust form of organization. The Sherman Act of 1890, as interpreted by the United States Supreme Court, did not begin to restrict business agreements in the least until the Addystone Pipe decision of 1899, nor to seriously affect the organization of consolidated businesses until the Standard Oil and American Tobacco decisions of 1911.

trustees of the trust were usually important men in the industry or else managers of the previous pool. They were usually selected for strategic purposes to represent the more important manufacturers and the various sections of the country in which the trust operated. These trustees held either the legal title to the shares of the corporations merged under the trust agreement, or else the titles in fee or the leaseholds of the separate pieces of real estate. The surrender of the stock to the trustees, rather than of the actual property, was the commoner method, that the constituent corporations might operate under their original charters. In return for the stocks or real estate, the trustees issued certificates which gave the registered holders rights under the original deed of trust but no legal title to the property held by the trustees. In this way the entire property acquired could be administered by the trustees as a unit for the interests of all, factories could be closed when it seemed wise, prices could be raised or depressed at will, and as the trustees were the legal owners of the constituent companies, there could be no destructive competition, no deception and no agressive policies maintained at the expense of one over another.[1]

The fourth stage was the *corporation*, or more properly the holding corporation. Owing to legal complications on the one hand and the liberality of the New Jersey statutes on the other, the old trusts were reorganized as holding corporations, which took title to the property previously held by the trustees. All consolidations promoted of late years assumed directly the corporate form of organization so that the stage of the trust, intermediate between the pool and the organized corporation, is seldom to be found after 1890 and never after 1892, except in Massachusetts, where it survives to the present, sanctioned by the English common law, and undisturbed by Massachusetts statutes. It is with the direct formation of the corporation that we are concerned in the general subject of the promotion of industrial consolidations.

[1] *Supra*, p. 116 and note, p. 116.
Owing to the few consolidations promoted prior to 1890, discussed in preceding pages, the trust appears infrequently.

2. *Time of Consolidation*

By reference to the table given on page 526 it appears that two of the companies discussed in this book were organized in 1890, one in 1891, one at the end of 1892, one only in the interval between 1893 and 1897, two in 1897, five in 1899, one in 1901, and one in 1902. There was, apparently, a movement toward consolidation which culminated in 1891, and another which culminated in 1899. These isolated cases are representative of two clearly defined movements toward industrial consolidation. The first, which it seems convenient to call the *minor cycle*, began in a small way about 1885, increased in importance and extent until 1892, when the signs of financial difficulties stopped further activity. With the panic of 1893, the movement ceased altogether. The second consolidation movement, which may conveniently be designated as the *major cycle* because of its greater magnitude, began in the latter part of 1896 with the first signs of returning prosperity, and increased in extent until 1899, when impulse to consolidate assumed almost the form of an industrial revolution. The movement ceased abruptly just before the depression of 1903. Four general reasons may be stated to explain the concentration of industrial promotions about the years 1891 and 1899. Both years marked the crests of waves of business expansion. At such times (1) business men foresaw large profits as a result of increased demand not held in check by increased competition; (2) business men sought for access to larger sources of capital than the facilities of the local banks permitted; (3) large amounts of capital had been concentrated in a few hands, — like the life insurance companies, — and this capital was seeking a wider field for long time investment; (4) during the periods preceding the years in question, confidence in the value of railroad securities had been shaken by over extension in railroad building and the resulting reorganizations. As a result of these and other more special conditions both business enterprise and capital were attracted into the new field of industrial combination where profits, it seemed, could be obtained by merely stifling competition and adopting methods of large-scale production.

3. *Character of Promotions*

All industrial promotions may be divided according to the interests behind them into two classes. There have been promotions conceived, developed and consummated by the manufacturers themselves. The leather, cordage, asphalt and glue cases were distinctly of this kind. There have also been promotions which were brought about by an outside agent, — a promoter, — or by outside banking interests. The starch, glucose, cotton duck and shipbuilding cases were distinctly of this order. Other things being equal, the first type has been stronger on the manufacturing side, because the old interests have been more likely to maintain their active coöperation. The second class has been apt to be stronger on the financial side, because certain independent bankers had a direct personal interest in the corporation's continued prosperity. Sometimes the two forms of promotion have been mixed, as when a single manufacturer turned promoter, soliciting the coöperation of the other manufacturers and outside bankers, — such were the salt, malting and bicycle cases.[1]

4. *Purposes of Consolidation*

Two purposes lay at the bottom of every consolidation with which we are here concerned. The promoters believed that they would be able both to allay the disastrous effects of competition, and to bring into existence improved and economical methods of manufacture through production on a large scale. These two reasons were fully understood by all classes of people concerned. They were the mystic oracles which led the business competitors of years to join in a common undertaking; they were the baits which prompted the bankers to give financial backing to the extravagant enthusiasm of the promoters; they were the motives of personal advantage dangled before the eyes of an investing public; and they were the " signs of the time " about which public discussion of the " trust movement " cen-

[1] For specific details see table given on p. 538.

tered. Nor did these two reasons develop only as the consolidations became more frequent. Congressional debates leading up to the passage of the Sherman Act of 1890 are full of expressions of both of these ideas. The whole spirit of that Act was a desire to preserve to the nation the benefits of industrial competition in the belief that the economies of production on a large scale would be accomplished through the self-interest of the manufacturer. This was in 1889, fully a decade before the consolidation movement reached its height.

As the majority of the consolidations came into existence after the passage of the Act of 1890, the motive of suppressing competition was stated with less explicit emphasis than that of attaining the economies of large-scale production. The former was usually expressed by drawing attention to the percentage of the industry the new consolidation would control, and the reader of the prospectus was allowed to infer what would happen to competition in an industry where seventy to ninety per cent of the production was under one management. The promoters had been familiar, through the experience of the immediate past, with the effect of pools and trade agreements upon prices. They believed that with centralized control, possible only through centralized ownership, all the advantages of pooling agreements could be secured, and the disadvantages of personal disloyalty among the members of the organization avoided. This was the reasoning that lay in the back of the minds of those who were instrumental in bringing about the consolidations, but the degree of emphasis which it was given in appeals made to the public depended, to a considerable extent, upon the width of market sought for the securities of the new corporation. For example, when the United States Leather Company was organized, practically all of the stock was taken by the tanners. We therefore find very little said about the effect of the combination on competition, and nothing whatever upon the ability of the new corporation to control prices.[1] When, on the other hand, the United States Shipbuilding Company was promoted, the people interested were actively concerned in distributing

[1] *Supra*, p. 18.

its securities to an investing public. The promoters, therefore, advertised widely the alleged fact that the new corporation would control the most efficient and economical yards on the Atlantic and Pacific coasts.[1] The promoters, in the majority of cases, found themselves between the Scylla of the demands on the part of bankers and investors for a trade stability possible only through some degree of monopoly, and the Charybdis of public opposition to all forms of monopoly. For example, the banking interests of Drexel, Morgan & Co. refused to take hold of the old National Cordage Company until that corporation had secured the control of the Plymouth Cordage Company, so essential did they consider a high degree of monopoly to the permanent investment value of the Company's securities.[2] On the other hand, the feeling against "trusts" as enemies of competition was so strong that the large consolidations frequently found their customers discriminating against their products,[3] and their competitors advertising the fact they were "not in a trust."

The table given on the next page suggests the relatively large proportion of each industry controlled by the initial consolidation discussed in the previous part of the book. The figures at most are suggestive only for they are at best approximate. This average of 54% for the thirteen consolidations described is a fairly accurate index of the degree of monopoly attained by the great majority of combinations promoted during the periods discussed. Isolated examples may exist in which a combination secured the control of more than 90% of the American output of its particular product,[4] but such examples are in no sense indica-

[1] *Supra*, p. 480. [2] *Supra*, p. 131.

[3] The American Tobacco Company, with its usual adroitness, got around this discrimination by having some of its secretly controlled subsidiaries advertise their products as "not made by a trust." The Company applied the same device to discriminations in favor of the union label.

[4] Such as the American Chicle Company in the chewing gum, or the American Tobacco Company in the cigarette business. But these were marked exceptions. The former owed its position largely to the acquisition of the only popular brands on the one hand, and the Mexican sources of supply on the other hand. The Tobacco Company acquired its advantage from the control over the efficient machinery for the manufacture of cigarettes.

TABLE SHOWING PERCENTAGE OF CONTROL OF THE UNITED STATES PRODUCTION OF THE FOURTEEN PROMOTIONS DESCRIBED. THE PERCENTAGE REFERS, IN EACH CASE, TO THE CONTROL AT TIME OF PROMOTION. THE ORDER GIVEN IS THE ORDER IN WHICH THE PROMOTIONS HAVE BEEN DISCUSSED IN THE PREVIOUS PART OF THIS BOOK.

		Date of Promotion	% of Control
1.	United States Leather Company	1893	58 %
2.	National Starch Manufacturing Company	1890	70 %
3.	Glucose Sugar Refining Company	1897	85 %
4.	National Cordage Company	1890	40 %
5.	Westinghouse Electric and Manufacturing Company	1891 [1]	32 %
6.	National Salt Company	1899	17 %
7.	George A. Fuller Company	1901	40 %
8.	American Bicycle Company	1899	65 %
9.	American Malting Company	1897	41 %
10.	New England Cotton Yarn Company	1899	68 %
11.	Mount Vernon-Woodberry Cotton Duck Company	1899	73 %
12.	Asphalt Company of America	1899	80 %
13.	United States Shipbuilding Company	1902	35 %
14.	American Glue Company	1894	48 %
	Average		54 %

tive of the control secured by the great majority of the industrial consolidations. At the time the companies were incorporated their promoters enormously exaggerated the percentage of the market their consolidations would control, and the public, — especially the oratorical legislators, — exaggerated still further the estimate of the promoters. So that the uncritical public has easily acquired the habit of regarding all the "trusts" as possessing a practical monopoly of their respective businesses. From other evidence, too extensive to present in this connection, the present writer believes that the number of combinations which controlled less than 50% of the American production far exceeded in number those that controlled more than 50%.

Little information concerning the subsequent control of their markets by the various companies discussed can be gathered from these figures. The National Salt Company started with the smallest proportionate control, but in less than a year had

[1] It is obvious that the formation of the Westinghouse Company is not to be called an industrial promotion. In 1891, however, the Company changed from a local enterprise to one in which New York and Boston bankers were interested. In a sense the Company came into national importance in that year.

secured direct control over the market for nearly all manufactured salt produced west of the Rocky Mountains. The two corporations showing the largest percentage of control, — the Glucose Sugar Refining Company and the Asphalt Company of America,— were both stifled by new competition within two years of their formation. Furthermore there appears to be no correspondence between proportionate control of the market and subsequent financial success,[1] for those corporations with relatively high percentages of control of their markets met with reverses no less quickly than those possessing merely a moderate position in their industries.

To escape the dilemma of either arousing popular indignation by emphasis on the large proportion of the industry the new consolidation would control, and of failing to meet the demand of bankers and investors for a trade stability possible only through a relatively large control over production, the promoters usually threw the stress of their persuasion on the second fundamental purpose of consolidation, — economies of large-scale production. Here they were on secure ground. The bankers and investors

[1] An interesting case of the relative hold on its markets by a large combination, meeting with exceptionally fortunate financial success, is suggested by the United States Steel Corporation. Although this illustration is not pertinent to the present inquiry it is of interest in connection with studies of relative control at the time of promotion. The figures have been computed from data gathered by certain trade sources, believed to be reliable, and checked by other data secured by the present writer. The ten chief semi-finished and finished products manufactured by the Corporation have each been estimated separately for each year and the average computed after giving treble weight to the pig iron and double weight to the heavier semi-finished products. Thus, the percentage of control, at the time of promotion in 1901, was computed as follows:

Product	Pig Iron	Steel Ingots, Castings	Steel Rail	Structural Steel	Plates and Sheets
Percentage	41.2	67.3	59.8	64.1	64.6
Product	Rods	Miscellaneous Rolled Steel	Wire Nail	Tin Plates (Terne Plates)	Misc. Finished Rolled Iron and Steel
Percentage	77.9	29.	65.8	78.3	50.1

Estimate for Total Production 56.7.

Using the same methods, the relative position of the United States Steel Corporation in the iron and steel industry, — not including ore or coke control, — for each year was probably about as follows:

1901	1902	1903	1904	1905	1906	1907
56.7	57.1	56.6	54.8	54.0	54.3	54.4
1908	1909	1910	1911	1912	1913	
52.0	52.5	51.3	50.1	48.9	47.2 (approx.)	

had only favor for improved methods of production as their application would surely result in greater trade stability and increased earning power. The public, too, felt that any improvement in technical or business efficiency must ultimately benefit them through decreased cost of manufacture. At first there was doubt on the part of the bankers that the more diffuse ownership would promote real efficiency. This doubt finds expression in the first public offering of the National Cordage Company's Stock, in which the listing Committee of the New York Stock Exchange was reported to have said that the device of owner superintendents bidding against each other was "a pretty sound scheme of consolidation." [1] This was as early as 1891. By 1897, fears of reduced efficiency were less frequent. The promoters of the American Malting Company caused to be written in the records of the Board of Directors that the "net earnings of these properties would be at least $2,000,000 annually without raising the price to the consumer." In their statement to the *Commercial and Financial Chronicle*, the competitive earnings were given as $2,300,000 and the increase of $1,000,000 over the earnings of the competitive malt houses was to be effected "by reason of the reduction in the cost of administration, etc." [2] The "etc." was supposed to bring to the minds of investors among whom the periodical circulated the fringe of associations connected with "trust economies," then a prominent feature of public discussion. Not a single industrial promotion of the period omitted to make use of the doctrine of the economies of large-scale production to the utmost,[3] until finally, in the unfortunate promotion of the Shipbuilding Company at the very end of the period, shipbuilding authorities wrote letters stating that the economies resulting from centralized organization and administration would increase the value of the yards, worth not over $10,000,000 to $45,000,000.[4]

[1] XIII *R. I. C.* 127. Whole testimony reproduced in Dewing, *The National Cordage Company*, Harvard University Press.

[2] *Supra*, p. 273.

[3] This confidence in the economies of large-scale production, characteristic of all promoters of the time, is clearly discernible in the testimony of Charles R. Flint before the Industrial Commission. XIII *R. I. C.* 33.

[4] *Supra*, p. 479.

At the time the movement toward industrial consolidation was discussed, contemporary students laid emphasis upon and expended no little *a priori* reasoning in describing the economies in production to be made possible through the methods of business contemplated by a centralized ownership of many manufacturing plants. Clever students of economics went so far as to arrange tables showing the external and the internal economies to be effected by the new organization of business. Among the external economies were the savings in advertising, in purchasing, in traveling salesmen, in executive officers, in freight rates and in foreign agencies; among the internal economies were the greater command of capital, the larger surplus for experimental work, the better facilities for placing the right man in the right place, the wider opportunity for development work and the more intelligent organization of the purchasing and selling departments. Unfortunately, however, these analyses failed to take into account the fact that greater organization demands greater skill of management, and skill of management is not more easily attained because of elaborate organization.

In addition to these two main purposes, there were minor causes which lent favor to particular plans of consolidation. Property could be better preserved and divided in case of death,[1] there would be better facilities for obtaining credit, the securities would be made more attractive to trustees and other conservative investors. These purposes were always incidental to the two already defined.

5. *Prospective Profits determined on the Basis of Past Earnings*

The buoyant optimism of the successful promoter is well known and sometimes notorious. Yet the majority of men who were important in the promotion of industrial consolidations, during either the earlier or the later period, were impelled by no motives of deception. Aside from their belief in the new era of industrial efficiency to come through coöperation rather than competition, they were fortified by confidence that the previous earning of the companies entering the consolidation represented a minimum below which the earnings of the con-

[1] *Supra*, p. 18.

solidated company could not fall. The following table indicates the aggregate earnings of the various plants, — so far as can be ascertained, — which went to form some of the consolidations described in the first part of the book. In some cases, — as with the plants of the American Malting Company and the New England Cotton Yarn Company, — the statement of earnings is based on a reliable audit of the books of the constituent plants just prior to the consolidation. In other cases, the statements are largely matters of computation.[1]

TABLE SHOWING AGGREGATE EARNINGS OF VARIOUS PLANTS, PRIOR TO FORMATION OF CONSOLIDATIONS AND THE FIXED CHARGES OF THE CONSOLIDATION MADE OF THE PLANTS.

	Annual Earnings of Plants just Prior to Consolidation	Evidence upon which Statement of Earnings is made	Estimate made of the Probable Earnings after Consolidation	Annual Fixed Charges established by Promoters
United States Leather Company	$4,800,000	Statement at Time of Issuing Bonds		$360,000
National Salt Company	450,000	Estimate by Promoters	$600,000	...
United States Realty and Construction Company	3,800,000+	N. Y. S. Ex. Listing Application Estimates	.	...
American Bicycle Company	4,900,000+	Average of Four Preceding Years	..	482,500
American Malting Company	1,300,000	Audit of E L. Suffern	2,300,000	. .
New England Cotton Yarn Company	1,106,197	Audit of Deloitte, Dever, Griffiths and Company	1,600,000	285,000
Mount Vernon-Woodberry Cotton Duck Company	1,100,000	Based on $593,703 for Preceding Six Months	...	350,000
International Cotton Mills Corporation	700,000	Estimate Based on Averages for Periods of Years, Printed in Syndicate Prospectus. Most of them Audits	1,500,000	. .
Asphalt Company of America	570,000	Author's Computation of Earnings of Subsidiaries during 1898[2]	...	1,500,000
United States Shipbuilding Company[3]	1,942,522	Computation of Independent Auditors	2,225,000	800,000

[1] With but few exceptions, the statements of earnings have been based on computations which rest on sources not absolutely reliable. I have, therefore, placed beside the statement of earnings, the method by which it is reached.

[2] The year 1898 was very much demoralized owing to the stubbornness of competitors over contracts. Estimates were based on the amount of pavement being laid, the normal profit on raw asphalt, and the normal profit on paving contracts. The Asphalt Company of America could regard its subsidiaries as having a "normal" earning capacity of about $1,800,000. "Normal" earning capacity, however, never returned.

[3] Not including the Bethlehem Steel Company's earnings.

It was not until long after the industrial consolidations were formed, that it became generally recognized that the "previous earnings" gave no reliable data for estimating the future earnings.[1] But at the time of promotion, the promoters who advertized widely the past earnings of their plants did so with the implicit faith that the consolidated company could make at least as much profit as the various plants in competition with one another. And had they not advertized the previous earnings, the careful investor would have inquired for them, so confident was the public that the centralized control was at least as efficient as competitive and unorganized ownership.[2]

6. *Assets and Capitalization at Time of Promotion*

No judgment of the subsequent success or failure of an industrial consolidation can be formed from the correspondence or disproportion between the tangible assets acquired by the corporation and its issued capitalization. Conspicuous cases of failure exist where the assets exceed the capitalization, conspicuous instances of success exist where the capitalization is several times the assets. Still it may be instructive to compare the two sets of figures. The form of capitalization, bonds or stock, is much more important than the amount, in furnishing evidence to explain the causes of failure.

On the average, so it appears, 40% of the par value of the total issued securities represented actual tangible property. Omitting the Westinghouse Electric and Manufacturing Company and the American Glue Company, corporations in no sense industrial consolidations, the percentage of tangible property is 37%. Considering those consolidations which issued bonds, the percentage of tangible property is less than 1% greater than those which issued all stock. It appears, then, from these few cases, that there is no substantial truth in the assertion frequently made that those consolidations which issued bonds were more conservatively capitalized than those which issued no bonds. Of the three consolidations which show the

[1] A valuable recent article entitled "The Abuse of Audits in Selling Securities" was published in the *Journal of Accountancy* for October, 1912.

[2] For the earnings of these same companies after consolidation, see page 547.

	Total Bonds Issued	Total Stock Issued	Total Securities	Approximate Ratio Bonds to Stock	Tangible Assets (without "good-will")	Per cent Tangible Assets of Total Securities	Immediate Market Value of Company's Securities
						%	
United States Leather Company	$6,000,000	$125,000,000	$131,000,000	1: 21	$60,000,000	46	$50,600,000
National Starch Manufacturing Company	3,837,000	8,516,900	12,353,900	1: 4	3,750,000	30	11,000,000
Glucose Sugar Refining Company	no bonds	37,166,500	37,166,500	....	7,500,000	20+	22,500,000
National Cordage Company	no bonds	15,000,000	15,000,000	....	4,000,000	27	12,000,000
Westinghouse Electric and Manufacturing Company	no bonds	8,843,700	8,843,700	....	9,000,000	102	5,450,000
National Salt Company	no bonds	5,000,000	5,900,000	....	2,000,000	33	2,275,000
United States Realty and Construction Company	no bonds	61,000,000	61,000,000	....	22,000,000	36	30,000,000
American Bicycle Company	$9,650,000	26,995,000	36,645,000	1: 3	14,000,000	39	16,500,000
American Malting Company	no bonds	26,250,000	26,250,000	....	7,000,000	27	16,000,000
New England Cotton Yarn Company	$5,700,000	10,000,000	15,700,000	1: 2	9,250,000	58	11,700,000
Mt. Vernon-Woodberry Cotton Duck Company	13,000,000	9,500,000	22,500,000	1: 1	8,000,000	35	13,000,000
Asphalt Company of America	30,000,000	30,000,000	60,000,000	1: 1	12,000,000	20	36,000,000
United States Shipbuilding Company	26,000,000	45,000,000	71,000,000	1: 2	14,000,000	20	43,000,000
American Glue Company	....	....	....	....	....	65	
Average Percentage Tangible Assets to the Par Value of Issued Securities	....	....	....	....	....	39.8	

lowest ratio of assets to capitalization, the United States Shipbuilding Company, the Glucose Sugar Refining Company and the Asphalt Company of America, one had no bonds and of the other two, one had half its capitalization in bonds and the other over a third. It is interesting further to note that no intimation can be gained concerning the subsequent success or failure of the corporation, from the proportion between assets and capitalization. The Glucose Sugar Refining Company, with the lowest relative proportion of property, never failed in the legal sense, maintained the dividend on its preferred stock, and its security holders received a bonus of new securities in the reorganization. At the reorganization of the New England Cotton Yarn Company, — the corporation having the highest proportion of fixed assets next to the American Glue Company, — the common stock was extinguished and the preferred stock heavily assessed.

It does appear, however, that there is a rough approximation between the volume of securities issued in excess of the value of property and the comparative control of the market. Thus the two corporations having the largest percentage of control of their respective industries have the smallest proportion of assets to the total securities. The correspondence cannot be pressed too far, but would indicate a basis of truth in the assertion that prospective monopoly profits were capitalized.

Arranged in Order of Control of Industry	Percentage of Control (table, p. 526)	Percentage Excess of Securities Over Assets (data from table, p. 532)
Glucose Sugar Refining Company	85 %	80 %
Asphalt Company of America	80 %	80 %
Mount Vernon-Woodberry Cotton Duck Company	73 %	65 %
National Starch Manufacturing Company	70 %	70 %
New England Cotton Yarn Company	68 %	42 %
American Bicycle Company	65 %	61 %
United States Leather Company	58 %	54 %
American Glue Company	48 %	35 %
American Malting Company	41 %	73 %
George A. Fuller Company	40 %	45 %
National Cordage Company	40 %	73 %
United States Shipbuilding Company	35 %	80 %
Westinghouse Electric and Manufacturing Company	32 %	0
National Salt Company	17 %	67 %

7. *Form of Securities issued at Time of Promotion*

Much more important than the amount of capitalization is the form it takes. A company might issue stock to the par value of many million dollars, and though the dividends were meagre, the corporation itself might be in excellent financial condition. If one-tenth the amount were in bonds bearing fixed interest charges, a slight fluctuation in business might create a serious crisis. Fluctuations, are, of course, relatively more pronounced among industrial enterprises during the first years of their life than with railroads and public service companies. This difference shows itself in the usual form of the capitalizations. Bonds are less common among industrials,[1] whereas practically every railroad company [2] in the United States and every public service company except a few Massachusetts gas companies are loaded liberally with funded debt. The first part of this statement was truer ten or twenty years ago than it is now, for as industrial corporations become stronger they find it expedient to issue bonds at interest rates lower than those at which preferred stock can be marketed. Of the four earlier industrial promotions with which we were concerned, none issued any bonds whatever except the National Starch Manufacturing Company. In the period before 1893, bonds were issued, if at all, at times of reorganization in order to fund floating obligations.[3] Of the ten promotions discussed belonging to the second period, five issued bonds. This was a disproportionately large number as compared with the condition among all the promotions of this second period and the relatively frequent occurrence of funded debt may be an indication that we have here one of the chief causes that brought about financial failure.

[1] The present writer does not believe this to be as clearly true as is usually presumed, especially if considerable periods of time are taken account of.

[2] The Delaware, Lackawanna and Western Railroad is not an exception to this rule, as many of its leased subsidiaries are heavily bonded.

[3] Like the bonds of the United States Rope and Twine Company, issued at time of reorganization of the National Cordage Company in 1894. *Supra*, p. 146.

The preferred stocks issued during the earlier period had, in general, somewhat higher rates of dividends than those of the later period. Of the five cases of the earlier period, all issued preferred stocks. As one, the National Starch Manufacturing Company, had two issues of preferred stock there were in all six issues. One bore cumulative dividends of 7%, four 8%, and the other 12%. Of the ten promotions of the second period, seven issued preferred stock, and of these all save one bore 7% dividends and the exception 6%. In brief, the tendency of the earlier period was toward high dividend paying preferred stocks and no bonds, while the tendency of the second period was toward a lower rate of preferred stock dividend and the issue of bonds.

The table on the following page gives in brief form the bonded debt and preferred stock issues of the various promotions discussed. The interest charges and preferred stock dividend charges are valuable for comparison.

8. *Promoters' Profits*

The term *promoters' profits* is very loosely used. To some people, usually those ignorant of financial matters, it has come to mean the difference between the par value of the securities issued and the tangible value of the property acquired. Such a view is so far from the truth that it would call for no comment, were it not apparently the idea in the minds of men who seek to make it the basis of restrictive legislation. It presumes that a man may acquire the plants in an industry for the par value of securities on the basis of the actual worth of the plants and then issue securities to himself in an amount far in excess. Such a simplicity on the part of the original owners of the plants has never, to the knowledge of the present writer at least, been encountered among American manufacturers. Sometimes, with possibly more reason, the term promoters' profits has meant the total par value of securities taken, as their personal compensation, by the men who were instrumental in forming the consolidation. But if this meaning is accepted, one must remember that the par value and the actual value of the

Initial Promotion	Date	Bonds			Preferred Stock (Income Bonds)			Total Amount Charges	Per cent of Bonds to Preferred Stock	Percentage Interest to Contingent Charges
		Amount	Interest Rate	Interest Charges	Amount	Interest Rate	Contingent Charges			
National Cordage Company	1890	....	..	...	$5,000,000	8%	$400,000	$400,000		
National Starch Manufacturing Company	1890	$3,837,000	6%	$230,220	2,219,400 1,846,800	8% 12%	399,168	629,388	40%	57%
Westinghouse Electric and Manufacturing Company	1891	....	....	....	3,642,150	7%	254,950	254,950		
United States Leather Company	1893	6,000,000	6%	360,000	62,282,300	8%	4,982,584	5,342,584	9%	7%
American Malting Company	1897	....	....	...	12,500,000	7%	875,000	875,000		
Glucose Sugar Refining Company	1897	....	....	....	13,139,300	7%	919,751	919,751		
National Salt Company	1899	....	....	....	2,400,000	7%	168,000	168,000		
American Bicycle Company	1899	9,650,000	5%	482,500	9,294,900	7%	650,643	1,133,143	104%	74%
New England Cotton Yarn Company	1899	5,700,000	5%	285,000	5,000,000	7%	350,000	635,000	114%	83%
Mt. Vernon-Woodberry Cotton Duck Company	1899	7,000,000	5%	350,000	6,000,000	5%	300,000	650,000	116%	116%
Asphalt Company of America	1899	30,000,000	5%	1,500,000	....	...	....	1,500,000		
United States Realty and Construction Company	1902	....	....	...	27,500,000	6%	1,650,000	1,650,000		
United States Shipbuilding Company	1902	26,000,000	5%	1,300,000	20,000,000	6%	1,200,000	2,500,000	130%	108%

securities were entirely different, and that this compensation quite generally took the form of common stock, the actual market value of which was very much less than the presumptive par value.

The term is best used to indicate the compensation received by one or more individuals for the service of putting together the combination of plants. Infrequently this service is paid for by itself; quite generally, one might say almost universally, the promoter is expected to assume some risk, particularly that involved in procuring the necessary ready money. The functions of securing the options on the plants and formulating the financial plan, — the true services of promotion, — are so generally united with that of banker, that it is difficult to find a case in these studies where the so-called promoters' profits were for promotion service alone. The nearest approach to such simple form was in the promotion of the United States Shipbuilding Company in which a single "promoter" secured options on the manufacturing plants. In the case of the Glucose Sugar Refining Company promotion, one man received $500,000 in common stock for his services as "arranger" of the combination. He was to receive, in addition, $500,000 for obtaining the necessary money. As he was unable to accomplish this part of his work, a syndicate took over the bankers' function and received a bonus in common stock for its services.[1] In such simple promotions as the National Starch Manufacturing Company[2] and the United Starch Company,[3] the promoter assumed the risk of obtaining the necessary money or bank loans quite as much as that of obtaining the options. In addition to payment for the service of procuring both the options and the money, the promoters' profits usually included, too, the lawyers' fees and incorporation expenses, and smaller expenses incidental to launching the enterprise, — although these were frequently arranged for separately as in the promotion of the Glucose Sugar Refining Company. Without going into detail, and with allowance for reasonable overlapping of functions,

[1] *Supra*, p. 80.
[2] *Supra*, p. 54.
[3] *Supra*, p. 61.

	Who performed the Service of obtaining Options	Compensation for obtaining Options	Who performed the Service of obtaining Money	Compensation for obtaining Money
United States Leather Company	Manufacturers	No Direct Promoters' Profits	Banker	10% of Money in Common Stock
National Starch Manufacturing Company	Promoter	$1,545,750 in Common Stock	Promoter	No Separate Compensation
United Starch Company	Promoter	500,000 in Common Stock	Promoter	No Separate Compensation
Glucose Sugar Refining Company	Promoter	500,000 in Common Stock Plus bonuses to Other Promoters	Syndicate	142% in Common Stock for each $100 of Preferred Stock bought at par
National Cordage Company	Manufacturers	Unknown	Bankers	Discount on Preferred Stock sold
National Salt Company	Manufacturer Acting as Promoter	No Direct Promoters' Profits	Syndicate	100% in Common Stock for each $100 of Preferred Stock bought at par
United States Realty and Construction Company	Manufacturers	$6,000,000 in Common Stock	Syndicate	100% in Common Stock for each $100 of Preferred Stock bought at par
American Bicycle Company	Manufacturer Acting as Promoter	Unknown	Bankers	7½% discount on bonds and some securities.
American Malting Company	Promoter	See Fourth Column	Bankers	Bankers and Promoters Together Received $7,750,000 in Common Stock
New England Cotton Yarn Company	Local Banks	Common Stock	Banker	$5,000,000 Common Stock all went to Bankers and Promoters
Mount Vernon-Woodberry Cotton Duck Company	Promoter	About two-thirds of Common	Syndicate	About one-third of the Common Stock
Asphalt Company of America	Manufacturers	$3,000,000 in Bonds	Stockholders	Privileged Subscription to Stockholders
United States Shipbuilding Company	Promoter	$5,000,000 four-fifths Stock	Trust Company	$2,500,000 in Stock

the division of both service and profits, for promoter and banker, in the promotions discussed in the earlier part of this book may be given as in the table on the preceding page.

In a theoretic case direct promoters' profits may be looked upon as the volume of money or securities left in the hands of the promoters of the enterprise after the plants have been paid for and the money necessary to start the company obtained. When it is possible to determine the money or securities paid for the plants and the securities allowed the bankers and public for obtaining the requisite money, it is merely a problem of subtraction to ascertain the securities remaining in the hands of the promoters; in but few cases is it possible, or worth the great effort, to obtain these figures exactly, so that the promoters' profits in these instances can be expressed only in approximate amounts.[1]

The indirect promoters' profits, made through the sale of plants at excessive prices, are even more difficult to estimate than the direct promoters' profits. In one instance only, that of the Asphalt Company of America, was an attempt made to estimate these profits. In that case the eight men in direct control of the promotion received $5,500,000 in bonds in excess of the value of their properties, — in addition to a direct promotion profit, going directly to three of the eight, of $3,000,000. In addition the interest, which it was desired to eliminate from the field, received $4,500,000 in excess of a reasonable value; so that the indirect promoters' profits amounted to $10,000,000, or one-third the total bonds issued in acquisition of the various constituent properties. Large indirect promoters' profits were obtained also at the time of the promotion of the Glucose Sugar Refining Company and the American Malting Company.

The extravagant feature of a promotion is usually connected with the indirect rather than the direct profits. These indirect profits go to the manufacturers and frequently to the public stockholders of the corporations absorbed. In the purchase

[1] This detail was entered into in the case of the National Starch Manufacturing Company, p. 53.

of the plants that constituted the American Malting Company, a maltster who sold his plant reported that the money, — not securities, — he received was exactly twice the reasonable value of his malt house, and that the prices in money received by the other maltsters bore an equal or greater proportion to the true value of their property. In the promotion of the New England Cotton Yarn Company, the consolidation having the largest proportion of assets to securities among all those considered,[1] the indirect promotion profits paid to the owners of the constituent properties, — in this case the public stockholders of the mills, — can be accurately estimated as at least $2,000,000, in money.[2] This was in one of the most conservative of promotions. The difference between the real value of their property and the price the original owners received represented a permanent handicap fixed upon the consolidation at the very start. And what was true to a small degree in the New England Cotton Yarn Company, where the indirect profits passed to the public, was true to a much greater degree where the promoters and the manufacturers were the same, where sellers and buyers were one. In every promotion the excessive prices paid to the owners of the plants placed a burden on the new company from which it was never relieved.

The distribution of securities in what one might call a typical promotion is suggestive. In a previous table it was shown that, of all the promotions described in this book, including corporations with and without bonds, the total tangible assets averaged

[1] See table on p. 532. The proportion of net assets to securities was exceeded by the Westinghouse Company in 1891, — but this was not a consolidation, — and the American Glucose Company, — which did not fail.

[2] The market value of the stocks of the mills acquired by the New England Cotton Yarn Company the year before was $5,600,000, their book value was $6,700,000 without allowing for the antiquated character of the plants. The stockholders received $8,300,000 in money for their shares. So rapacious were some of the public stockholders, that long letters and editorials appeared at the time in the local papers, asserting that the prices offered by the bankers for the mill shares were " unjust " to the small stockholders. From various sources of information it seems apparent that the small stockholders, — those who held five shares or less, were most exorbitant in stating the supposititious value of their shares. It was this class which would see most clearly the iniquity of " stock watering."

40% of the total issued securities. The remaining 60%, representing usually the overlying stocks, was distributed among five separable interests, although in the majority of cases one or more were merged. These five interests were (1) the promoter who secured the options, (2) the banker who stood god-father for the enterprise or underwrote its securities, (3) the manufacturers who received a price for their plants in excess of their value, (4) the public who received a bonus of common stock for purchasing the securities of the enterprise, (5) the attorneys and others who did the work of incorporating the consolidation.[1] Looking at the matter still in terms of a typical promotion, it would appear that of the 60% in securities above the value of the property, 10% went to the promoter for his service, 10% to the banker for his services, 20% to the manufacturers as a gift in excess of the value paid for their plants, 15% to the public as "bait" to induce the purchase of the securities and 5% for the direct labor incident to incorporation. Such figures represent the roughest approximation. They are susceptible to infinite variations according to the proportions of bonds and stocks, to the period of promotion, to the kind of industry, to the prevailing sentiment of the public. As rough approximations, however, they are believed to be fair statements of average conditions. Taken as such they would indicate that in a typical promotion of an industrial consolidation, with issued securities amounting to $10,000,000, the following allotments would occur:

[1] Typical illustrations of the various shares in the excess of capitalization over assets may be drawn from the previous historical sketches. (1) The promoter's share was represented by the $500,000 of common stock that went to the promoter of the Glucose Sugar Refining Company. (2) Bankers' commission was represented by the $600,000 in common stock that went to the bankers who bought at par $6,000,000 of debenture bonds of the United States Leather Company. (3) Indirect promoters' profit of the manufacturer was represented by the $10,000,000 in bonds, which the nine promoter-vendors of the Asphalt Company of America received in excess of the value of their properties. (4) Bonus to the subscribing public was represented by the $4,500,000 of common stock which the public received for subscribing for $9,000,000 of the preferred stock of the American Malting Company at par. (5) Expense of incorporation was represented by the $350,000 of common stock which was to go to the attorneys at the time of the United States Shipbuilding Company's promotion.

Actual value of plants	$4,000,000
Excess price paid for plants	2,000,000
Compensation to promoter	1,000,000
Compensation to banker	1,000,000
Bonus of securities issued to public	1,500,000
Organization expenses	500,000
	$10,000,000 [1]

9. *Lasting Influence of the Promotion Period*

It is unfortunate that the amount and form of the securities issued at the time of promotion should have so deep and lasting an influence on the future success of the corporation. This influence is out of proportion to the consequence attributed to the form of capitalization by the promoters themselves. That form is largely determined by accident. At most, a trivial whim led the promoters of the United States Shipbuilding Company to shift from all stock in the first unsuccessful plan to bonds and stock in the Trust Company of the Republic plan. Yet this slight change, neither essential nor relevant to the rest of the promotion, was the one feature which precipitated the reorganization. Had the promoters clung to the all stock distribution of capitalization, they could have made all the other blunders which attended that unfortunate undertaking, while yet the United States Shipbuilding Company would, in all probability have endured until today. Perhaps there is no epoch in the history of an enterprise which needs wise judgment and foresight more than the period of promotion. It is essentially a period of "pure management." It requires a wisdom that cannot be entirely a matter of experience, for at the inception no two enterprises are alike in either general outlines or specific details. Yet as in the illustration given above transitory or at most insignificant motives determine the central features of a plan of promotion. Custom, at one particular time, favors bonds rather than preferred stock, the cumulative rather than the non-

[1] Such generalizations as are represented by these hypothetical figures are based on the roughest and most "composite" presumptions. The proportions vary greatly according to the character of securities issued and distributed.

cumulative dividend rate; or the investment market at the moment favors one form of security more than another. The narrowness of vision of the ordinary promoter is all the more startling when one remembers that he must aim to determine events through a long period of time. He projects present expedients into the future, as do the framers of a constitution or the organizers of a new society. The corporation is his creature. As he plans, so will it develop, so also will it succeed or fail. These things the promoter seldom consciously faces, he merely follows the momentary paths of least resistance. The banker requires money for his services, — the promoter decides to issue bonds rather than stock because the bond market is then exceptionally good. The new enterprise will appeal to Massachusetts investors, — he then incorporates the enterprise in Massachusetts and issues stock alone, because stock is there a non-taxable security. These and other similar temporary considerations are frequently the motives that determine the permanently important features of a financial plan.

Width of vision measures the quality of business genius. The reason why the Standard Oil Company has been preëminently successful is not because the corporation enjoyed a monopoly of the Pennsylvania oil fields, nor because it transported its products under favorable contracts, nor even because its competitors lacked adequate business ability, but because the Directors always built for the future, never for the present alone. Fully half the annual earnings were reinvested in new, and largely experimental, equipment. The men saw every move in terms of a wider perspective than their competitors. It was a question of imagination and it is such imagination which the usual promoter lacks. He possesses a full complement of what is commonly called optimism, but this optimism is of a diffuse, decentralized character, existing more as an emotional attitude of mind than a rational analysis. At all events, he does not project his belief in the inherent success of the enterprise beyond an immediate present, the limits of which are confined to the establishment of the business. Sometimes, especially if the promoter anticipates a permanent connection with the new company,

his field of vision extends a little beyond the first year of the company's history; but almost without exception it fails to include a sufficient extent of the future to enable him to grasp the corporation as a permanent creature. He does not take into consideration financial organization, trade policy, domestic and foreign markets, relations with customers, bankers, employees and the interplay of all these. Yet he is building the foundations for all these elements of the business, and the stability of these foundations is to be tested under circumstances and during stretches of time that lie beyond his horizon.

Fortunately for our business enterprise, the main features of financial plans have been wrought out through a process of trial and error and do not arise, in separate cases, through the whim and caprice of individual business organizers. During the first epoch of industrial promotions, from 1888 to 1893, many different features were tried. Dividend rates on preferred stocks had a wide flexibility from the 12% of the Starch Manufacturing Company down to the absence of definite rate in the Diamond Match Company. During the later period of industrial consolidation from 1897 to 1902, precedent had more largely determined the form of a financial plan. It came to be recognized that there should be no bonds and that the preferred stock should not carry over 7% dividends. If the promoter held closely to this custom, no originality was required of him.[1] He was required only to pass judgment on the general soundness of the enterprise. The details of promotion became matters of rule of thumb. When the promoter varied the rule, as in the case of income bonds with the Mount Vernon-Woodberry Company, or mortgage bonds with the New England

[1] Such established custom in promotions is illustrated admirably in the public service enterprises, the shares of which are now being placed on the market. At the present time, if an electric lighting consolidation is to be promoted, no originality is required in the main features of the plan. Bonds bearing the almost invariable rate of 5 % are issued for approximately 85 % of the tangible value of the combined properties. Preferred stocks are then placed on the property to such amounts as will enable the promoters to market them to bankers for about $95 a share. These bear 7 % interest if the enterprise is west of the Mississippi or south of Maryland, and 6 % if in the northeast. Common stock is then issued to an amount that will give to it an initial market of about $20 a share, without undue support.

Cotton Yarn Company, in industries where experience had proved bonds inexpedient, he placed upon the undertaking a handicap which, in these two cases at least, precipitated failure. Excessively capitalized and unwieldy as were the majority of the industrial consolidations, they had the saving virtue of being capitalized in such manner that failure through lapse of payments on bonds was impossible. This reluctance to burden the corporation with bonds seems to have been due in the first place largely to the insight of a few influential men who were suspicious of human nature, and of the new gospel of business consolidation. Although profoundly under the spell of the industrial revolution which would substitute large-scale production for personal supervision, and community of interests for competition, they continued to believe that a manufacturing business was at best precarious and that no human intelligence could forecast the future with such clearness as to determine the charges a business could easily bear. This implied confession of ignorance showed profound business insight.

CHAPTER XXI

THE CONDITIONS AND CAUSES LEADING TO REORGANIZATION

1. Early Financial Management.
2. Capital Charges prior to Reorganization.
3. Fundamental Causes for the Failure of Industrial Combinations.
4. Motives Leading to Reorganization.
5. Forms of Business Failure.

1. *Early Financial Management*

THE link between the promotion of the corporation and its subsequent failure and reorganization lies in the early management. It was pointed out in the previous chapter that large presumptive earnings were each time promised on the basis of estimates formed from the earnings of the constituent companies before the consolidation. Unfortunately the first statements of the consolidated companies failed, except in a few instances, to justify the promises. The discrepancies were even more marked than the published figures indicated because in no case were adequate charges made to depreciation on plants which were in low physical condition at the time of consolidation. Without commenting on the sets of figures the following table shows the disparity between the promised and the actual profits. Including two instances, — strangely the two cases showing the most precipitous fall in earnings, where the profits were temporarily inordinately large, — the average earnings were exactly two-thirds the amount anticipated.[1]

[1] A remarkable instance of the divergence between the actual earnings and the anticipated earnings is afforded by the early history of the American Hide and Leather Company. This corporation was never reorganized, but as it is engaged in the same general business as the United States Leather Company, a comparison of the experience of the two corporations is valuable. Just prior to the final promotion of the American Hide and Leather Company, Thomas J. Ryan, one of the promoters, stated that the "economies of consolidation would not fall below \$4,000,000" (*Shoe and Leather Reporter*, May 18, 1899) and that the consolidation would be able to pay from \$5,300,000 to \$6,900,000 in dividends, "7 % on the preferred and from 8 to 12 % on the common stock" (*Boot and Shoe Recorder*, May 24, 1899). The published reports for the first few years, prior to 1908, were

EARNINGS BEFORE AND AFTER CONSOLIDATION

	Approximate Annual Earnings of Plants Prior to Consolid. (p. 530)	Earnings after Consolidations			Percentage of Earnings after Consolidation to those before
		Time covered by first Statement in Months	Amount of Earnings given in First Statements	Annual Rates represented by First Statement	
United States Leather Company	$4,800,000	12	-$980,494d	Deficit	0%
National Salt Company	450,000	8½	429,000	$605,800	134%
United States Realty and Consolidation Company	3,800,000	9	1,417,686	1,900,000	50%
American Bicycle Company	4,900,000	10	1,000,000	1,200,000	24%
American Malting Company	1,300,000	15	502,125	401,700	31%
New England Cotton Yarn Company .	1,106,197	11½	1,041,500	1,086,500	98%
Mount Vernon-Woodberry Cotton Duck Company	1,100,000	4	609,433	1,828,300	166%
International Cotton Mills Corporation	700,000	12	388,936	388,936	56%
Asphalt Company of America	570,000	12	225,837	225,837	40%
United States Shipbuilding Company [1]	1,912,522	12	1,078,261	1,078,261	56%
Average Initial Earnings	.	. .	. .	....	65%

In discussing the policy of industrial consolidations during the years following their promotion, it is important to distinguish between those corporations which were hampered by predetermined payments of fixed charges and those which were altogether free from bonded debt. In the former case payments of interest charges were authorized from the first. In the expectation that the earnings of the consolidations would equal those of the constituent companies, the directors had no difficulty in believing that the fixed charges placed on the consolidated companies by their promoters were reasonable, and they authorized such payments before any statements of total earnings were available. Any apparent lack of conservatism in paying interest on bonds was merely one aspect of that lack of conservatism on the part of the promoters which was shown by incorporating bonds in the financial plans. The following table shows the early capital charges of those companies having bonds.

not clear, but judging from available data, the net earnings, — after slight depreciation charges corresponding to sinking fund on the bonds, — were less than $167,000 for the first year of the company's business. This was, on the whole, a fairly prosperous year in the leather business.

[1] The Bethlehem Steel Company not considered.

TABLE SHOWING EARLIEST EARNINGS AND CAPITAL CHARGES OF COMPANIES BEARING BONDS

Company	Period covered by Earliest Statement	Net Earnings	Charges during Period			Apparent Surplus
			Charges	Dividends	Total Payment on Capital Liabilities	
United States Leather Company	May 1, 1893 to May 1, 1894	$980,494 loss	$360,000	. .	$360,000	–$1,340,494 d.
National Starch Manufacturing Company	April 1890 to April 1891	1,100,000 approx.	230,220	$684,632	914,852	+ 185,000
American Bicycle Company	Oct. 1899 to Aug. 1900	1,000,000 approx.	400,000	...	400,000	+ 600,000
New England Cotton Yarn Company	July 15, 1899 to July 1, 1900	1,041,500	285,000	337,500	622,500	+ 400,000
Mount Vernon-Woodberry Cotton Duck Co.	Sept. 1, 1899 to July 1, 1900	1,368,813	541,666	332,500	874,166	+ 494,647
Asphalt Company of America	July 1, 1899 to Dec. 1, 1899	780,019	750,000	....	750,000	+ 30,019 [1]

[1] Subsequently shown to be a deficit.

When, on the other hand, the policy presented by those corporations without bonds is considered, no deflection of responsibility on to the shoulders of the promoters is permissible. Purposely the charges had been made contingent on the assumption that the earnings of all industrial enterprises were subject to abrupt fluctuations and what should be judicious payments on capital could not be foreseen with any degree of precision. The directors had not their hands tied in any way with regard to a dividend policy. Yet in numerous cases they cast all reasonable conservatism aside, and declared dividends almost from the first. This policy brought about its natural evil consequences. At least four of the failures described in the first part of this book were the direct result of the misguided efforts of directors to pay dividends when the earnings should have been conserved. The failure of the Corn Products, the American Malting, the United States Realty, and the New England Cotton Yarn Companies were the result of such payment of dividends on stock, which, in each of these cases, were unwarranted. They represented, except for the subterfuges of accounting, an actual impairment of capital. Indirectly similar early payments of dividends seriously weakened the United States Leather Company, the National Cordage Company, the National Salt Company, the Consolidated Cotton Duck Company and the first International Cotton Mills Corporation, although it would be somewhat of an exaggeration to say that the difficulties of all these companies were due entirely to payment of unearned dividend.

TABLE SHOWING EARLIEST EARNINGS AND CAPITAL CHARGES OF COMPANIES WITHOUT BONDS

Corporation	Period Covered by First Statement	Reported Net Earnings	Dividends During Period	Apparent Surplus
Glucose Sugar Refining Co.	Sept. 15, 1897 to July 1, 1898	$1,863,157	$919,751	$943,406
National Cordage Co.	Oct. 31, 1890 to Oct. 31, 1891	1,406,313	1,300,000	106,313
National Salt Company	April 15, 1899 to July 1, 1899	108,000	42,000	66,000
United States Realty and Construction Co.	Sept. 30, 1902 to June 30, 1903	1,417,686	1,218,889	198,797
American Malting Co.	Oct. 1, 1897 to Dec. 31, 1898	502,125	877,800	−375,675

The haste with which these early dividends were declared was at variance with the simplest principles of sound finance. In the majority of cases dividends were begun almost immediately after the organization of the corporation, before an opportunity had been given for the new enterprise to manifest its independent earning power. In very few cases did the directors have unquestionable evidence from a careful audit of the books to prove that the dividends had been earned, and the basis of their judgment was seldom more than a mere estimate, which failed to make adequate provision for depreciation. In the instance of the American Malting Company, subsequent revelations showed that the Directors could not have known what the earnings actually were at the time the first dividend on the stock was declared because in the court testimony it appears that the general books had not then been balanced from the books of the branches. Similar conditions probably existed in other corporations where the methods of accounting have not been subjected to as rigorous a scrutiny.

Why was such lack of conservatism shown by these corporations? Able financiers were on the directorates in nearly every case. Joy Morton was on the Starch, Glucose and Salt Boards. Grant B. Schley on the Malting; Stillman, Speyer and Steele, — among the ablest bankers in New York, — were on the Realty Directorate. The strong Boston interests of the National Shawmut Bank and Kidder, Peabody & Company were on the New England Cotton Yarn Board. This lack of conservatism could not be attributed to narrow financial judgment for these men were, at the same time, directing the affairs of some of the most successful and important corporations in the country.

One motive that often prompted the declaration of dividends was a desire to make a market for the stock. This probably was not the motive in the cases of the United States Leather and National Salt Companies. It probably was the motive in the Mount Vernon-Woodberry, and the United States Realty cases, for dividends were continued during the life of the underwriting syndicates and were discontinued just before or soon

after the distribution of the securities. In other instances, as the Glucose Sugar Refining Company and American Malting Company, the stock was very largely held, while the dividends were being declared, by the Directors who had obtained it at the time of the promotion. In a most conspicuous way the desire on the part of promoters, members of underwriting syndicate, and early holders of stock to realize a profit at the earliest time prompted to an uncritical extravagance and lack of sound, conservative judgment which not only thwarted their own intentions, but indirectly brought disaster upon their corporations. Every evidence shows that had the early interests been willing to forego immediate profits and conserve the funds of the corporations the enterprises could have been placed on a sound footing and the men themselves have secured vastly greater return.

2. *Capital Charges prior to Reorganization*

The same problem of conservatism of management presents itself in the period immediately before reorganization. Here, too, the problem appears in different aspects according to whether we are dealing with corporations having bonds, and therefore fixed charges which must be met, or corporations without bonds and so without the necessity of meeting capital charges.

Again it will be convenient to consider first those corporations having bonds. Altogether the successful reorganizations of twenty-four corporations were studied. All resulted directly or indirectly from some form of failure.[1] Eighteen of these twenty-four corporations had outstanding issues of bonds of some considerable size. At the time of reorganization of these eighteen corporations, eleven had paid unearned interest in the year before the crisis. The other seven corporations paid interest that they had earned, but three of these seven corporations paid out dividends which they had not earned, in addition to the interest. In other words, fourteen of the eighteen corpora-

[1] For complete list of reorganizations, see Plates A and B, chap. xxii.

tions with a bonded debt paid either unearned interest or unearned dividends just prior to their failure.[1]

As a general thing, where the corporation had bonds, the confession of financial failure was postponed as long as conditions would in any way permit. If the corporation had issued only a relatively small amount of bonds, new obligations were assumed to meet the interest on the old. Such cases, however, were rare because ordinarily the earlier issue was secured by a first lien on the corporation's property, and it proved almost impossible to float new bonds to perpetuate the life of the old. A frequently followed practice was to borrow from reserve funds in the hope that those conditions which made it difficult to meet the fixed charges might prove only temporary. Thus the Directors of the National Asphalt Company drew upon the reserve fund to the extent of over $1,000,000 in order to meet the interest on the outstanding bonds of the Asphalt Company of America. Commoner still was the practice of allowing the floating indebtedness to increase gradually, while gross income that should have been used to meet merchandise accounts was deflected to interest payments. This was done especially before the two Westinghouse failures, — though not to an extent that would explain the rapid increase of floating debt, — and again before the failure of the Starch Manufacturing Company, of the Mount Vernon-Woodberry, of the Standard Cordage, of the New England Cotton Yarn Companies, to mention only a few instances.

The tendency to borrow on short term notes to meet pressing fixed obligations was always apparent in the history of these industrial enterprises. It was the result, perhaps the necessary result, of extreme fluctuations in trade. Not one of the corporations studied was free from such variations. An enormous business, like that of the Westinghouse, varied from gross sales of $20,000,000 in 1908, and a deficit of $1,000,000 to gross sales of $30,000,000 in the following year, and a net profit above all

[1] The four corporations that paid neither unearned interest or dividends were

United States Leather Company	Reorganization of 1905
Westinghouse Electric and Manufacturing Company	Reorganization of 1907
American Malting Company	Reorganization of 1905
International Cotton Mills Corporation	Reorganization of 1913

charges of $3,000,000; and what may befall a business as standardized as the Westinghouse must occur to a greater or less extent with every industrial corporation. It is largely because of these clearly recognized fluctuations of trade, that a sound financial policy dictates the use of stock rather than bonds. And it should be remarked at this point that the strength of our so-called "industrial trusts" lies partly in the fact that the majority of them were promoted without bonds. But when foolish promoters had once overloaded a corporation with liabilities bearing fixed charges, it became the duty of the subsequent management to get along as best it could. A default in bond interest payments was very disastrous to the credit of a corporation, as well as to the market price of its securities. It was disastrous to its trade as well. It was noted that the General Electric Company suffered only a decline of 25% in its business directly after the panic of 1907, whereas the Westinghouse Company, which failed, suffered over 37%. This fact was perfectly well known to the managers of all these corporations. It was their policy, therefore, to preserve the integrity of the corporation at all hazards, even though it involved increasing the floating debt to ward off an impending crisis. And if the crisis proved general, as did the depressions of 1903 and 1908, the corporation was generally successful in recovering its ground provided the fundamental earning power of the business were sound. Many corporations borrowed money to meet their fixed charges during these years which the return of prosperous trade conditions enabled them to repay; but when the fundamental earning capacity of the corporation was not sound, when the failure to earn fixed charges was due to lack of earning power, then borrowing only postponed disaster. The policy adopted by most of the corporations to meet their fixed charges as they fell due was, therefore, on the whole expedient provided the business possessed powers of recuperation. But in meeting these charges the directors merely changed an immediate liability to a deferred one, so that if the floating debt increased out of proportion to the increase of trade or the carrying power of the business, failure resulted. In almost every instance,

TABLE SHOWING CAPITAL CHARGES PRIOR TO FAILURE OR REORGANIZATION OF COMPANIES WITH BONDS

Corporation	Date of Failure or Reorganization	Floating Debt at Time of Failure	Amount of Bonds Outstanding	Rate	Payments During Preceding Year: Fixed Charges[1]	Preferred Stock Dividends	Common Stock Dividends	Total Disbursements	Net Earnings Previous Year	Net Surplus from Business of Year	Amount of New Money Added at Time of Reorganization
				%							
United States Leather Company	1905	Unknown	$5,280,000	6	$316,800	$3,736,938		$4,053,738	$3,962,067	− $91,671 d.	0
National Starch Manufacturing Company	1900	Unknown	4,950,000	6	297,000	....	....	297,000	Unknown		
Corn Products Company	1906	Unknown	7,195,000	5+	392,500	1,916,651	....	2,309,151	$2,081,966	− 227,185 d.	0
National Cordage Company	1893	$11,986,418	6,000,000	6	360,000	400,000	$1,100,000	1,860,000	2,710,749	850,000	$9,000,000
United States Cordage Company	1895	2,500,000	3,850,000	6−	520,000	..	....	520,000	Net Loss	Deficit	3,000,000
Standard Rope and Twine Company	1905	Unknown	2,740,000	6	164,400	. .	...	164,400	Net Loss	Deficit	1,076,530
Westinghouse Electric and Manufacturing Co.	1907	$14,241,763	30,000,000	5+	2,454,500	400,000	2,100,000	4,954,500	$5,069,068	$114,568	12,000,000
American Bicycle Company	1902	1,500,000	9,150,000	5	457,500	. .	....	457,500	Net Loss	Deficit	2,429,676
American Malting Company	1905	Unknown	4,066,000	6	205,500	.. .	....	205,500	$617,822	$412,322	0
New England Cotton Yarn Company	1903	$2,060,000	5,263,000	5	265,000	175,000	....	440,000	365,272	− 74,727 d.	2,000,000
Mount Vernon-Woodberry Cotton Duck Co.	1901	Unknown	13,000,000	5	650,000	. ..	....	650,000	152,000	− 498,000 d.	2,750,000
United States and Mount Vernon Companies	1905	Unknown	8,000,000	5	400,000	82,500	....	482,500	566,086	+ 83,586	
Consolidated Cotton Duck Company	1910	Unknown	8,000,000	5	425,400	.. .	....	425,400	− 80,810	− 506,210 d.	3,700,000
International Cotton Mills	1913	Unknown	2,000,000	6	60,000	295,825	....	355,825	388,936	33,111	8,000,000
Asphalt Company of America	1900	Unknown	29,830,755	5	1,491,538	....	...	1,491,538	225,837	−1,265,701 d	2,500,000
National Asphalt Company	1902	Unknown	35,830,755	5	1,791,538	.. .	....	1,791,538	371,428	−1,420,110 d.	2,400,000
United States Shipbuilding Company	1903	$3,335,264	24,500,000	5	1,225,000	.. .	....	612,500	2,700,000	+2,000,000	2,625,000

[1] Not including interest on floating debt.

the crisis, when it did occur, was precipitated directly at the very time the floating debt became unmanagable. To outward appearances the failure was due to insufficient working capital, and inability to secure more liberal allowances from the banks, but the truth of the matter in the majority of cases was that working capital and bank credit had been used in the past to meet interest payments. The crisis resulting primarily from capital disbursements had been shifted forward and given the form of a crisis due to impaired working capital.

The preceding table shows the floating debt and payments to interest and dividends in the period immediately before the announcement of the crisis. The column on the right indicates the amount of new money added at the time of reorganization. The treatment of this assessment does not properly belong at the present point of the narrative but is added as evidence to bear out the generalization made in the preceding paragraph, that the crisis was directly precipitated by an overload of floating debt, although primarily caused by the deflection of too much money from the normal demands of the business to the payment of fixed charges. The table includes only corporations having a considerable issue of bonds.

The other class of corporations, those without funded debt, present an even more striking lesson in the effects of a lack of conservatism. Of the twenty-four reorganizations, five were concerned with corporations that had no previously existing issues of bonds. Of these corporations, four declared dividends during the year previous to the crisis, and of these four, certainly three failed to earn the dividends paid. The fourth corporation probably did not earn the dividends paid, although a surplus was shown by using questionable methods of accounting. The table on the following page indicates the payments of dividends in these five cases.

The payment of dividends on stocks in the face of falling earnings and increasing floating debt cannot, like the payment of interest, be justified on grounds of expediency. The only possible reasons which could lead the directors of a corporation to pay out in dividends an amount in excess of the earnings

TABLE SHOWING CAPITAL CHARGES PRIOR TO REORGANIZATION OF CORPORATIONS WITHOUT BONDS

	Date of Failure or Reorganization	Floating Debt at Time of Failure	Preferred Stock			Common Stock			Total Dividend Disbursements During Preceding Year	Net Earnings During Preceding Year	Net Surplus from Business of Preceding Year	Amount of New Money Added at Time of Reorganization
			Outstanding	Rate	Dividends Preceding Year	Outstanding	Rate	Dividends Preceding Year				
Glucose Sugar Refining Company	1902	Unknown	$13,639,300	7%	$954,751	$24,027,300	6%	$1,441,638	$2,396,389		—$272,673	$5,000,000
National Salt Company	1901	....	5,000,000	7%	350,000—	7,000,000	6—	301,172	651,172	$38,915	—612,257	....
United States Realty and Construction Company	1903	....	27,500,000	7%	406,300	33,500,000	....	...	406,300	1,017,500	+ 611,200	None
American Malting Company	1900	$28,000,000	14,400,000	7%	977,550	14,500,000	....	....	977,550	368,000	— 609,550	3,600,000
Pope Manufacturing Company	1907	1,640,000	11,016,100	....	..	10,000,000	.	...	....	Small Profit	Profit	800,000

were ignorance of the true financial position of a corporation, the false belief in the immediate return of more prosperous conditions or the desire to give the corporation a more successful appearance among bankers and investors than its earnings warranted.

Summarizing the conditions of all twenty-four corporations, it appears that eighteen out of the twenty-four paid either unearned interest on bonds or unearned dividends on stock in the year just prior to the failure or reorganization. That is, 75% of the corporations studied were confronted with the necessity of reorganization at a time just following the payment of unearned capital charges.

3. *Fundamental Causes for the Failure of Industrial Combinations*

It is not difficult to summarize the underlying conditions and the causes of crises in the history of industrial corporations. Setting aside the American Glue Company, whose reorganization was due to special motives, every crisis studied was the result of financial embarrassment. These financial difficulties were not the consequence of over-capitalization as is usually alleged.[1] These corporations did not fail because the capitalization items were large or small. They failed because their earnings were inadequate for the load put upon them. If the load was especially burdensome by reason of heavy fixed charges and unwarranted dividend payments, the failure was all the more certain. The direct cause of failure in every instance was the deflection of working capital to the payment of interest and dividends.[2] Beneath this, as the fundamental cause, was the lack of judgment of promoters in placing bonds upon an untried industrial enter-

[1] For example, John Moody states "That in every case cited it may be seen that the chief fault has been the enormous over-capitalization." *Truth about the Trusts*, p. 368. This extravagant statement is made after an uncritical summary of eight industrial corporations then undergoing reorganization. Similar utterances are to be found in the public press, they are common to certain types of political speech and are not unknown in the halls of Congress, — especially frequent are they in the addresses of men who pretend an ability to legislate against corporate abuses.

[2] With the possible exception of the American Bicycle Company.

prise and the lack of conservatism of the early management in paying dividends without due regard to sound principles of finance. Every corporation discussed in this volume paid out interest or dividends in the face of falling earnings, and none need have suffered serious financial difficulties had the amounts paid in interest and dividends been conserved.[1] Many industrial consolidations more extravagantly promoted, with far greater discrepancies between assets and capitalization, have continued in business uninterruptedly to the present time and are prosperous, because their promoters issued no bonds, and their early directors exercised a wise conservatism.

These were direct causes. They do not explain, however, the underlying conditions that led to financial disaster. The great majority of the corporations discussed in this volume and in fact, the great majority of large corporations at present doing business represent industrial consolidations promoted in the early or the late nineties. As a group they failed. When judged in terms of the promises of their promoters their histories stand as striking acknowledgments of the inadequacy of mere consolidation as a basis of economic efficiency. Two separate and distinct sets of causes can be discovered to explain why the overwhelming majority of these industrial combinations failed to prove as successful as their promoters had anticipated. One set was psychological in character and concerned with the difficulties attending the administrative management of a large business. The other was economic in character and concerned with the difficulties attending the creation of a business organization sufficiently powerful to dominate an industry in the presence of actual or potential competition.

Without attempting to offer an exhaustive list of the personal causes of failure, one can see clearly at least six, every one of which, in varying degree, showed the difficulty of obtaining a sufficiently high degree of business ability to manage a large consolidation of manufacturing plants. (1) Foremost, perhaps, was the *diffusion of responsibility*. A man with ample business skill to manage a small factory was given the management of

[1] Again with the possible exception of the American Bicycle Company.

a group of plants widely separate and each operating under local conditions. He was then compelled to delegate the actual management to paid superintendents, over none of whom he had more than indirect authority. If he tried to manage the scattered plants as he had his single plant, he found that the enormous detail involved too great a burden for his mind; important matters passed unnoticed, and the local superintendents degenerated into automatic parts of a machine, without initiative or power of assuming responsibility.[1] If, on the other hand, he delegated a large share of the authority to his local superintendents, he found that he required men of marked business ability to manage the separate plants efficiently; he required, in fact, a degree of ability which commanded so high a salary as to absorb the presumptive economies due to consolidated management. (2) Lack of knowledge of *individual employees*. A successful competitor of a large consolidation declared that his success was due to the fact that he knew the parents and grandparents of the employees in his mill. He had watched them from childhood. He knew the skill and deficiencies of each, and therefore, the kind of work and the condition which would bring out the greatest earning power of each. Such possibilities of individualized superintendence of labor were impossible where the organization had grown so large that all personal contact between employer and employee was lost. (3) Lack of *loyalty of officers* and directors. In order to maintain the continuity of the separate businesses it was the custom to have the more prominent men who had disposed of their plants to the consolidation serve as members of the Board of Directors, or as managing officers of the corporation. But the center of their loyalty was changed. They were no longer operating their own plants. Personal motives easily supplanted any feelings of responsibility they might have toward the great body of stockholders. As directors they were tempted to burden

[1] As a large manufacturer once expressed it, — there comes a point where the man in the twentieth story of an office building cannot make up, no matter how brilliant he may be, for the waste and shiftlessness of a variety of superintendents in many mills hundreds of miles away in all directions.

the consolidation with useless plants at personal profit, or to make advantageous contracts with other companies in which they were interested, or give employment to relatives at high salaries. They were tempted to speculate in materials in such wise that the burden of loss fell on the corporation, or to make purchases and sales of the corporations' securities, based on knowledge exclusively their own. If the body of stockholders found fault with such codes of business ethics, the directors could resign their positions and sell their securities. They could even enter into competition with the consolidation and grow strong through a knowledge of the trade enhanced by their previous connections. (4) Lack of attention to the *laborious parts of the business by the higher officials.* The directors considered their positions too important and their time too valuable to spend on matters of detail. Previously, as owners of competitive plants, they were at their business offices each day from early morning until late in the afternoon; as "Vice-Presidents," they were more often at the office of the corporation only from 10 until 3 o'clock, and not at all on Saturdays. They no longer felt obliged to sacrifice social pleasures for business motives. They were no longer concerned with petty economies of manufacture, insignificant alone but large in the aggregate. Even in the utilization of by-products, where one of the economies of large-scale production was supposed to lie, the executive officers would frequently take the position that the possible advantage was too insignificant to be worth their attention and trouble.[1] (5) *Prejudice of customers against improved methods.* There was, and still is, a group of men who are so blinded by an external appearance of efficiency that they have come to think that the more automatic and inpersonal a business

[1] There are two temptations which confront every director in a large corporation. The success with which a man, suddenly risen to influence, resists the feeling that he is too important to devote himself to the current detail of management and the feeling that he is in a position to profit through stock market manipulation measures his future success in the position of responsibility. No human mind is great enough to manage a large business with consummate skill and follow in detail the market quotations of its securities. It is a modern instance of serving two masters.

becomes the greater will be its productive power. Fortunately this theory is no longer widely held. But at the time the industrial consolidations were created it was popular. As a consequence the central management undertook to substitute a more scientific and carefully articulated method of producing and selling goods for the shipshod methods of the small establishments. In cases of a standardized product the application of more scientific methods to production were undoubtedly wise but in all branches of the selling organization they were an absolute failure. Few things count more in salesmanship than the personal magnetism of an able salesman basing his appeal on long established trade connections. The directors of the consolidation sought in the interest of organization and economy to replace high salaried salesmen by low paid order clerks. Many of these salesmen had been the proprietors of the old businesses, men who held their customers by family association, — the customers of their grandfather and great-grandfather perhaps. "Among the oldest houses doing business with us" was a bond which the force of circumstances broke with difficulty. Instead of profiting through this bond the new order of scientific salesmanship interposed the deadening influence of organization between buyer and seller. Customers found that they were no longer dealing with the son of their old friend, but with some cog in the machine designated as ABC. Before, they had arranged the terms of their contracts in a dingy office, replete with the memories of half a century; now their contracts were forwarded to them from a central office or delivered by the manager's secretary. As a result they often turned elsewhere.[1]

(6) *Prejudice of Customers against "Trusts."* There is a large body of intangible evidence pointing unmistakably to the fact that in the years immediately following the establishment of the large consolidations, many small manufacturers and merchants were influenced by the popular dislike of "trusts."[1] This

[1] An excellent illustration of this principle is afforded by an incident at the time of the promotion of the American Hide and Leather Company. This was the consolidation whose prospective annual profits were estimated by the promoters in excess of $5,000,000, of which $4,000,000 was to come from consolidation. (See note, bottom p. 546). At the time the promotion of the Company was discussed

feeling undoubtedly influenced customers in those cases in which the product of the consolidation was sold directly to the ultimate consumer, as with starch or bicycles. This feeling was especially conspicuous if the goods were sold directly to members of the laboring class who were led to believe that the rise of general prices, which set in about 1899, was due primarily to business concentration. The newspapers of a sensational tone exploited this feeling in their editorials and their cartoons; the competitors displayed the words "not made by a trust" on their goods.

Foremost among the various economic conditions which militated against the success of the industrial consolidations was the fact that the mere consolidation of factories could not inhibit competition, because the cost of production and distribution was not reduced to such a point as to render the further investment of capital unremunerative. In certain isolated cases it was found that the greater the aggregate capital investment in a single plant, the lower was the production cost per unit of output.[1] But in the vast majority of cases the point of maximum economy of production was reached far below the total capital investment of the consolidated plants. Large-scale production to the degree contemplated by the consolidated company proved unnecessary and a smaller company often

the *Boot and Shoe Recorder*, a prominent trade journal, sent out a letter to two hundred and fifty shoe manufacturers, reading as follows, "In case this combine (the American Hide and Leather Company) goes through, and you were purchasing stock, whom would you favor, manufacturers outside the trust, or the trust itself?" A large number of answers were received. More than half expressed bitter antagonism against the prospective consolidation. A few replies only were indifferent. The following was an example which, although superficial in its reasoning, shows the innate trade prejudice from which the majority of consolidations suffered.

"Lynn, Mass.
May, 23, 1899.

Boot and Shoe Recorder:

We would prefer to buy from the outside firms every time, for the simple reason that we believe they could serve our interests much better than the trust; the manner in which the trusts' stocks have been watered and the enormous expense they have been under are reasons why shoe manufacturers are not going to be benefited by this combination.

W. J. Creighton & Co."

[1] Steel mills, for example.

found itself able to attain the point of maximum economy of production with a relatively lower capital expenditure.[1] The resulting competition came from three sources, — the old competitors not absorbed by the consolidated company, new competitors attracted to the industry by the exorbitant profits promised by the promoters of the combination, and the old manufacturers, who, having sold out their antiquated plants to the consolidated company, invested the money they received in new factories. The old competitors, contrary to expectations, were stronger after the consolidation was formed than before, because the more compact organization of the enemy made the points of attack clearer, and the greater control over volume of output maintained by the large company insured a steadier market for the product with less abrupt and disastrous fluctuations in prices. The new plants built by those who entered the

[1] The entire question reminds an observer of one of those reversible reactions with which the chemist is familiar, which run in opposite directions until equilibrium is established. Maximum efficiency in the organization of industry can be likened to the balance point of a variety of opposing forces. Certain influences and conditions make for increased efficiency and economy under a large organization, and certain other influences and conditions make for waste and increased costs of production. Maximum efficiency is attained in that degree of concentration of organization in which the resultant of the positive forces of economy and efficiency and the negative forces of waste and diffusion has its greatest positive value. This may be illustrated by a few symbols: —

Let m represent the number of business units.

Let a represent the sum of all the forces which make for efficiency as m is increased, — economy of buying, of traveling salesmen, of distribution of by-products, of access to capital, etc., etc.

Let p represent the sum of all the forces which make for waste and decreased efficiency as m is increased — lack of personal touch, loose safeguards, cumbersomeness, difficulties of credit, diversified responsibility, the cumulative effects of bad buying, etc., etc.

Then ma has a positive efficiency value and increases toward an indeterminate maximum value at rate r.

Then mp has a negative efficiency value and increases toward an indeterminate maximum value at the rate r'.

A specific value for the ratio $\frac{r}{r'}$ will vary according to the nature of the business.

For all values of m above 1, mar will have a certain value to which will correspond another value for mpr'.

Then $mar-mpr'$ will measure the efficiency of any group of units, m, and the most efficient organization of industry will be for such value of m, that $mar-mpr'$ shall be maximum.

industry because of presumptive high profits were erected under the advice of trained engineers according to improved design; and mechanical efficiency of construction, superior to that of the older plants of the consolidation, went a long way toward counterbalancing the handicap of inexperience. And when the old manufacturers built new factories, they had every advantage in their favor, — the understanding of the most appropriate situation for a plant, knowledge of the most modern and economical type of equipment and of the best construction engineers, familiarity with secret processes culled from years of experience, familiarity with trade conditions and with the special wants of influential customers.[1] In cases where the large-scale production of the consolidated company was apparently more economical than the methods pursued by the small competitor and therefore gave to the larger company a seeming advantage in lower costs of production, certain unforeseen wastes, singly unimportant, tended, in their cumulative effect, to counterbalance the more obvious economies.[2] Besides these objective advantages the

[1] The production costs of the American Malting Company, using largely the floor system, compared with those of competitors using the compartment system (p. 270) are pertinent.

[2] The specific mention of five such wastes illustrates the point. (1) *Difficulty in purchase* of raw material. When the consolidated company purchased a raw material, like corn or cotton, in the open market, it was at a distinct disadvantage as compared with its competitor. Large orders, necessary to meet the demands of the company's mills had to be made openly, and with a full knowledge of the trade. The competitor not requiring so much material was able to buy odd lots secretly and at a lower price. Thus Charles Pope was able to buy corn at better advantage than the Corn Products Company (p. 76), and small yarn mills had an advantage over the New England Cotton Yarn Company in the purchase of raw cotton (p. 320). (2) The consolidated company was *less able to avoid overproduction in a falling market*. It was tempted to keep its mills in operation, in order to maintain its organization, when prudence prompted the curtailment of production. And even when overstocked the small manufacturer was better able to dispose of his surplus in small odd lots without breaking the current market price for standard goods. (3) The consolidation was *susceptible to political and legislative attacks* and sometimes to blackmail. Heavy legal fees, contributions to campaign expenses, even the expenses of a lobby seemed necessary in order to fortify the consolidation against the onslaught of unscrupulous politicans, and those who regarded the treasury of a large corporation as their legitimate prey. Many small and unnoticeable wastes occurred through the inability of the large corporation to defend itself against attacks. For illustration, a certain corporation fre-

small competitors were stimulated by the ambition of "building up the business," and they brought to the task a perseverance, energy, and personal attention to each customer that lay beyond the reach of the larger and better systematized but less adjustable selling organization of the consolidation. And when it came to a contest of strength, contrary to the usual presumption, the small competitor was at an advantage. Every cut in price below the actual cost of production meant a loss to the consolidation of thousands of dollars where it involved only a loss of hundreds to the small producer, and by bidding on small contracts at ruinous prices he could establish a price level at which his larger competitor would be compelled to take all contracts, large or small.

One at least of two conditions was necessary for the success of a consolidation. It must have had at its command executive ability of an unusual order, such that the various human difficulties which beset the administration of a large business were successfully met;[1] or it must have been secure

quently in a position to feel the effect of political attacks, owns a building in the centre of a large eastern city. The land upon which the building stands is valued, for taxation purposes, at an amount more than double the land on the two side lots owned by private individuals. (4) The heavy investment of the consolidation in specialized machinery made it especially *susceptible to changes in trade conditions* resulting from the developing of substitutes or the changes of public tastes. This was admirably shown by the effect of the discovery of petroleum asphalt on the earnings of the National Asphalt Company, or the cessation of demand for bicycles on the earnings of the American Bicycle Company, and the great expense involved in shifting the machinery for the manufacture of bicycles to that for the manufacture of automobiles. The small competitor was able to respond more quickly to changes in trade conditions or public taste. (5) Not the least waste of the consolidation was its *unwillingness to change its methods of production* in accordance with improvements in technique. One of the widely heralded economies of concentrated ownership was the greater ability of the large organization to experiment in new processes. But unfortunately the exploitation of improved methods of manufacture involved the destruction of valuable machinery. And, stimulated by a false economy, the consolidation refused to make the improvements until the cheaper production costs of competitors made such a step imperative.

[1] The Standard Oil Company is the most striking example of a business grown to large proportions solely through superior business ability. The skill of administration exercised by the managers of this Company is the most remarkable of its kind in the annals of American industry. Other successful consolidations, such as the American Brass Company and the American Radiator Company, owe their successes to superior business ability.

against unrestricted competition through having a monopoly control over some essential raw material,[1] some patent,[2] or some franchise.[3] In rare instances only are these conditions realized.

4. *Motives leading to Reorganization*

It is clear from the cases outlined in the first part of this book, that reorganization succeeds a crisis in the affairs of a corporation. This crisis may be due to one of three primary causes, — (1) personal motives of the officers or prominent stockholders, (2) the legal proceedings of the Government, or (3) financial difficulties.

Reorganization, as a result of the *personal motives* of influential stockholders, is of relatively seldom occurrence. In railroad finance it is best illustrated by the unfortunate formation of the Rock Island Company, by William N. Moore and his associates, in such manner that the control of a large railway system was secured through the control of a small issue of preferred stock in a holding company. The only instance of the kind here is that of the American Glue Company, in which dissension in the management supplied the fundamental motive for reorganization. That the personal motive should be of relatively slight importance is readily seen when one remembers that reorganization is essentially a matter of financial policy, and would be resorted to only as a financial expedient. That this is true is attested to by the fact that until the Standard Oil and American Tobacco Supreme Court Decisions in 1911, the crises that brought about practically every instance of industrial reorganization had been due to present or threatened financial difficulties. Personal motives might be important in determining the trade policy of a corporation, or some episodes in its history,[4] but they would hardly be of sufficient significance

[1] The Aluminum Company of America, International Nickel Company, American Chicle Company.

[2] General Electric Company, Mergenthaler Linotype Company.

[3] American Telephone and Telegraph Company, United Gas Improvement Company, Consolidated Gas Company.

[4] Such as the formation of the New York Glucose Company, as an act of retaliation on the Corn Products Company. *Supra*, p. 85.

to lead to an entire capital readjustment, such as is involved in a reorganization.

Reorganizations as a result of *legal proceedings* of the Government have occurred only since 1911, as a result of the Supreme Court decisions covering the applicability of the Act of 1890 to large manufacturing businesses. Without attempting to discuss the political or economic grounds upon which the Act of 1890 was founded it is of interest to note that the present significance of the law depends on an effort on the part of the United States Supreme Court to differentiate between various forms of economic monopoly on the ground of social expediency. No monopoly is stronger than that exercised by the small country storekeeper nor with respect to control of its markets weaker than that of the Standard Oil Company, or some of the larger consolidations against which Congress has sought to legislate.[1] The thing that the advocates of the law had in mind was something entirely different from the negative injunction, — there shall be no monopoly. It was the positive injunction, — there shall be competition. The former is impossible of enforcement because under some conditions a monopoly price is fixed by economic conditions.[2] The latter is not only enforceable, but rests, in the

[1] This statement is made with care. Monopoly, in the only strict interpretation which has an economic significance, is ability to fix a monopoly price. Some real monopolies are more successful in effecting this end than others, but the single *sine qua non* of a monopoly is the existence either actually or potentially of price fixing power. The country storekeeper possesses this power because of the prohibitive expense involved when his customer attempts to trade elsewhere. Competition cannot arise because the limited trade of the district will not support two "overhead charges." The storekeeper's prices are, therefore, limited at an upper level only by the cost his customers would incur in transporting or having transported to them the goods from another source. But as the carriage on small parcels is high, and as the farmer finds it proportionately expensive to go to the next store some miles away, where the same conditions prevail, he concludes that it is cheaper to pay the local storekeeper the monopoly price. In other words, the level of competitive prices is so high that the storekeeper's monopoly price is less. The Standard Oil Company, on the other hand, can distribute its products only in competition with the oils from other fields not under its control. The price of oil is, therefore, fixed actually by domestic competition and potentially by world competition. A recent fall of prices of light oils in eastern markets as the Texas Company extended its operations is a concrete illustration of this principle.

[2] The case of the country storekeeper, for example, mentioned in the previous note.

opinion of the present writer, upon sound theories of economic and social policy.[1]

The evolution of the present attitude of the courts has clearly shown the emphasis to be on the positive value of competition, not on the negative danger of monopoly. So that the degree of competition attainable in the presence of the large corporation has come to be the test of the corporation's contribution to public welfare and, therefore, of its legality. It is not the presence of monopoly, but the absence of the conditions of competition that has been the cause of the crisis that has led to the enforced reorganization of the Oil, Tobacco, and Powder consolidations. And this degree of competition moreover, has been itself subject to judicial definition on the grounds of expediency. The term "reasonableness," which has come to play an important part in current discussions, is merely another phrasing for the idea of sufficient competition to insure a degree of economic efficiency consistent with the greatest public welfare. In the end this can be told only from the analysis of the special conditions of any case. Under our present understanding of the Law of 1890, and the court decisions arising out of it, we may say that a crisis in a corporation's affairs necessitating reorganization by judicial procedure arises when the conditions as to competition in the industry in which the corporation operates are not conducive to the greatest public well being. In some industries this may connote a relatively high degree of monopoly[2] in others a relatively large margin of competition.[3] Reorganiza-

[1] See footnote 1, p. 569.

[2] Telephone, express, sleeping car.

[3] International Harvester Company, now under judicial review. *All* the basic patents of harvester machinery have run out and the International licenses other manufacturers on the "attachment" patents it controls. There are very large competitive corporations, — Deere, Rumely and Case, — to mention only three. It must be said that the social expediency that determines the Government to preserve a high degree of competition in this industry is based on "the lowest prices for farmer's goods" policy. The strongest defense of the Harvester Company's attorneys, in view of the underlying motives of the Company's prosecution, would be to prove that the International can afford to sell goods to farmers on a lower basis than if the Company were reorganized into integral units. This they have not recognized, but have based their defenses, thus far, upon the technical construction of the Law of 1890 as applied to their Company, which is of secondary significance.

tion that follows a judicial finding that the presence of the corporation inhibits the degree of competition necessary for public welfare is merely a readjustment of the corporate affairs so that greater apparent competition is insured. The large corporation breaks up, in theory at least, into competitive units. Reorganization becomes disintegration.[1]

5. *Forms of Business Failure*

With one exception all the reorganizations discussed in this book, and by far the vast majority that have ever occurred, were the direct consequences of failure to earn enough money. Either the business had been conducted at a loss for a shorter

[1] The policy pursued by the judicial department of the government is based on the belief that public interest is best served by competition, rather than large monopolistic production, even though the units are under governmental regulation. This policy is based on sound economic principles. In spite of the extensive discussion of a substitute for competition one notes with relief that the temper of judicial opinion in the Federal Courts is still in accord with the well established economic principles that the highly competitive organization of industry is productive of the highest efficiency and the lowest real cost of commodities.

The only excuse for the substitution of governmental regulation for competition among large industrial units is the resulting efficiency of production. Any other result would mean an increase in absolute costs and a retardation of industrial progress. In regard to the possibility of a governmentally controlled business producing its goods more cheaply, two comments are pertinent. (1) The ability to manage successfully a large industrial unit of many branches operating under diversified conditions is exceedingly rare, — far rarer than is generally conceded. It requires peculiarly developed psychological powers of accurate memory, balanced judgment and almost prophetic imagination. These powers are not readily discernible; they can be developed to their highest point of efficiency only under the spur of the strongest incentives of personal loss through failure and personal gain through success. The effectiveness of these forces prompts the able administrator to stretch every nerve to succeed. This means decreasing production costs, and inevitably, through the mere action of competition, lower costs to the consumer. (2) Nothing seems so effective as a spur to efficiency, — whether in business, art or professional work, — as the spur of competition. It is psychologically impossible for a man to race against himself, except for short periods and under special conditions. The presence of actual or potential competition is the only sufficient spur for long sustained effort at the highest pitch of effectiveness.

If the two observations just made are true, any tendency on the part of the government to lessen competition and substitute for it a paternalistic control over large corporations must inevitably result in lowering their vitality on the one hand and their zest for increased efficiency on the other. As a result their production costs will increase.

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or a longer period, and reorganization was resorted to as a relief from accumulating burdens, or else some sudden change in external or internal conditions, like a crisis or a sharp rise in the cost of material, necessitated an entire recasting of the financial organization. Owing to the importance of the subject, it is convenient to recognize various types of failure.

The various kinds of failure in business enterprises may be conveniently arranged according to four different classes, neither mutually exclusive or overlapping. They may be designated as business, financial and legal failure, all subject to precise empirical tests, and economic failure which is largely a matter of theoretical description and determination.

The phrase, *business failure*, has been used here to indicate those cases of pronounced ill-success in business in which the earnings were insufficient to pay even the wages and the cost of raw material let alone interests and profits. They were the most pronounced cases of failure recognizable. They were of much commoner occurrence among industrial enterprises than among railway and public service companies, owing to the relatively pronounced fluctuations in trade in the former class, and the higher proportion of gross receipts that go to material and labor. No railroad would have failed in the depression of the nineties had it not been compelled to meet interest charges in some form, whereas there are many small manufacturing businesses which produce gross earnings entirely insufficient to meet current expenses for labor and materials. Insolvency in such cases is a necessary consequence in the long run, although the crisis may be postponed as long as the proprietors and stockholders continue to meet the deficiency. In the end the business might be wound up so that no loss fell upon outside parties, but the enterprise would be quite as surely a business failure as if the owners had not come forward with new capital, and the creditors had petitioned the corporation into bankruptcy. Business failure of a pronounced form was seldom followed immediately by bankruptcy proceedings. In the majority of cases, the stockholders either subscribed new capital when it was apparent that the business could not maintain its costs, or else induced outside

banking interests to step into the breach. This process might be continued until the stockholders had become discouraged or until all the capital has been mortgaged away. Enforced liquidation occurred only when the patience of the stockholders or the assets of the business were at an end. An enterprise may thus be a business failure for years without manifesting any evidence of defect except impaired credit and low prices for its securities.[1]

The term, *financial failure*, is used to indicate inability to meet any form of interest bearing obligation, — floating debts or capital liabilities. It is distinctly different from business failure. A corporation might long be a business failure, like the Standard Rope and Twine Company from 1896 to 1905, and not be a financial failure in that interest and maturing obligations were met as they fell due. On the other hand a number of the corporations with which this book is concerned were not business failures in any sense but yet were financial failures in their inability to meet their interest charges at a definite time.[2] Whether or not a corporation is to be considered a financial failure depends largely upon the policy of the promoters regarding the issue of bonds. The Asphalt, the Shipbuilding, the Mount Vernon-Woodberry Companies, for instance, would not have faced a crisis had the promoters issued stock entirely and not bonds and stock. On the other hand many industrial corporations which

[1] The most conspicuous instance of business failure described in the first part of this book was the continued lack of success of the cordage combination in the years following the reorganization of the National Company. From 1894 to 1912, a period of eighteen years, this business was continuously a business failure. Time after time one corporation after another was on the brink of bankruptcy when its security holders stepped forward and supplied new funds. This process continued until even the first mortgage bondholders of the last reorganization could realize but a small portion of their claims. Bonds representing money contributed at the time of the first reorganization had long since been reduced to stock and finally wiped away. Business failure was by no means absent from the history of other corporations with which we are concerned, but nowhere was it allowed to show itself so clearly or to run forward so continuously as in the succession of corporations which followed the old National Cordage Company. Ordinarily it was represented by some obscure phrasing as, — " The company's outstanding obligations are being pressed for payment and unless provided for will go to protest."

[2] The Asphalt Company of America, for example.

have endured to the present time would have failed in a financial sense had they been handicapped by even small issues of bonds.[1]

Legal failure is a phrase used here to denote financial difficulties followed by the intervention of a court in the appointment of a receiver. The tests for this type of failure are distinctly objective, the corporation being judged by the court insolvent under the law. At the same time, it should be remembered that litigation frequently accompanies or follows reorganization, and its mere presence is not indicative of legal failure. For example, the final reorganization of the United States Leather Company was followed by extensive litigation, but in no sense was the reorganization the result of the intervention of the court in the conduct of the corporation's business, nor was the corporation at any time insolvent according to the definition of the term in law.

The cognizance by a court of equity of the fact that the corporation is insolvent is not of great economic importance. Although for practical purposes the appointment of a receiver may be of moment it does not help to an understanding of the fundamental causes of failure, nor is it of especial significance in the subsequent reorganization of the corporation. Owing to the expense, the notoriety and the loss in "good-will," it is better for the principal interests in a corporation confronted by a crisis to effect a reorganization before it becomes necessary to appoint a receiver. Even after the appointment of a receiver, it is usually found that committees of security holders are the best means for rehabilitating the company. Eight only of the twenty-five reorganizations studied in this book were preceded by the confessed insolvency of the corporation and the appointment of a receiver. The proportion is surprisingly small when compared to railroad failures, and is explained by the greater simplicity of interests involved in an industrial reorganization.

[1] A number of the smaller industrial corporations having only preferred and common stock would have come under this heading, — United States Cast Iron Pipe Company, American Linseed Company, to mention only two. It is doubtful if, for example, the General Electric Company could have avoided reorganization in the depression of the middle nineties had the Company previously issued bonds to only a moderate amount.

The question of *economic failure* is essentially a matter of economic theory. To be regarded as a success from the economic point of view, a business enterprise must pay normal wages, a normal rate of interest, and a normal rate of profits. Society will not use the goods until long after labor has produced them, and wages represent the prepayment necessary to induce their production. The normal rate of interest represents the rate which is received at any one time for prepaying or discounting the future value of labor's products. It is the pecuniary inducement necessary to induce the prepayment of labor. In amount of rate it is identical for all industries at any one time,[1] and is determined by the balance between the motives, chiefly psychological, which tend to supply this discount or prepayment, and the demand which society places upon the goods produced through the prepayment of the services of labor. Interest rises either when the motives for discounting labor decrease, or when the demand of society for goods realizable only through paying labor to produce them increases.[2] It falls in the presence of the reverse of either of these tendencies. Under normal conditions it is self adjusting,[3] because the two tendencies are mutually limiting. Normal profits represent the return to the intellectual skill represented in conducting the enterprise. They are of two sorts, — (1) compensation for risk, or the payment for taking the risk that society will not want the goods after they are produced, although labor has been already paid for them; (2) the exercise of managerial skill in producing the goods with the least expenditure for labor, or in other words, at the lowest rate of

[1] It is needless for me to remark that I mean here pure or economic interest. The source of practically all the difficulty in our current theories of interest lies in the attempt to incorporate return on risk and business ability in investing capital in the conception of pure interest.

[2] Böhm-Bawerk would say goods produced by the roundabout process. The idea is the same. Society wants the goods which can be obtained only through paying labor now to produce them. The demand for discounting labor therefore increases.

[3] One is impressed very forcibly with the relative constancy of pure interest from the Greeks and Romans to the present time. Of course the compensation for risk, which is usually incorporated with it, varies greatly according to political and social conditions.

discount. Any business is a failure in the economic sense which fails to produce these three payments.[1] Economic

[1] The task of applying this generalization to specific instances is difficult, because of the necessity of determining objectively the element of normal profit. Wages are fixed by standards prevalent in the industry, and the local cost of living; pure interest is the same in every industry. Profits, however, are essentially individual with each enterprise and each business manager. To decide whether they are sufficient in any specific case requires a valuation of the risk involved in that particular enterprise, and of the efficiency of management exercised by those in control. Such valuations are, obviously, almost impossible. They can only be gauged in the most approximate terms. If the failure is sufficiently pronounced, and if the capital upon which interest is paid is of the form of a bonded liability, legal insolvency results. This is only in extreme cases, however. Many enterprises are, in the economic sense, failures, which the courts are never compelled to take cognizance of, because interest payments and profits are not in such form that they can be enforced at law. Moreover, under the custom of current corporate financing, neither interest nor profits are ever clear cut. The bondholder usually gets more than pure interest, because he must receive some compensation for risk, — which is more properly regarded as profit, — in order to induce the investment of his capital in an enterprise not absolutely certain. The stockholder receives his income partly as interest, and partly as profits. The salaries paid corporation officials are seldom the only profits they receive, for the managing directors usually prefer to receive some of their profits indirectly through the enhancement of the price of their shares that comes with reinvestment of surplus earnings in the enterprise. In actual experience it is, therefore, extremely difficult to determine exactly the economic profit yielded by any enterprise. Roughly it can be determined only by subtracting from the net earnings the pure interest on the amount of capital invested, and adding to the surplus the salaries of managing officials. It will not be found to correspond with any specific payment, dividends, salaries, or surplus earnings.

To determine whether an enterprise is an economic failure requires a little arithmetic. The first step is to determine what the economic profits ought to be by determining the risk involved in investing capital in the enterprise, and adding to this the theoretic worth of the services of the men governing the business. On the other hand, the profits actually made are determined by deducting from net earnings the pure interest on the capital investment, and adding to this amount the salaries of those who actually manage the enterprise. The specific instance of a cotton mill will illustrate the case. It is a fine goods mill of 50,000 spindles representing an actual investment of $1,000,000. The ability to manage well a mill of this character is not common. We will say the treasurer should receive $10,000, and the agent $5,000. These men could receive such salaries elsewhere so that their values are subject to competitive adjustment. Suppose, too, the experience of investors has led them to believe that about one in every twenty mills result in absolute loss of capital. (This risk element is necessarily theoretic. It simply means that the chances of loss in the cotton business are one in twenty, whether it takes the form of half loss in two cases out of twenty, or quarter loss in five out of twenty.) We can now compute the profits necessary, if this enterprise is to be considered an economic success. These amount to $65,000 ($\frac{1}{20}$

failure belongs to an essentially dynamic condition in either the corporation's history or the history of the industry. Static

(1,000,000) + 10,000 + 5,000). Now, in the concrete case we will suppose that the treasurer gives his service for nothing, as he has a large stock interest; and also that the agent accepts the position for $3,000 in the belief that the men with whom he has associated himself will advance him. We will suppose the mill to make an average net profit, during a number of years, of $87,000, after making fair allowances for depreciation. Let us say that pure interest is about 4.10 %. The actual profits of this mill are, therefore, $49,000. (Net income $87,000; less pure interest, $41,000; plus salary of management, $3,000 = $49,000.) In the economic sense it was a failure, then, although in actual dividends the stockholders may have been receiving something like 7 % on the par value of their shares. The actual profits were insufficient to cover the risk, and in the course of time, the failure of other mills, or the attraction of capital to other industries where the actual returns more nearly approximate the risk would gradually drive up the yearly profits to about $65,000, — provided, of course, our postulates are correct. Had the actual profits been in excess of $65,000, the gradual influx of capital into the industry would have driven them down to this stable figure. Of course, the risk element in any industry is continuously fluctuating, and the rate of pure interest moves by wide changes. The point of the present illustration is, that an enterprise is specifically an economic failure unless it can produce an adequate profit quite as much as adequate wages and interest.

Another illustration of these theoretical considerations, taken from actual experience, may make the distinctions clearer. We will discuss the United States Leather Company. This corporation started business in 1893, with approximately $60,000,000 of tangible assets, consisting largely of timber lands. There was no promoter's secret profit, or capitalized good-will. Men capable of managing an enterprise of this magnitude are rare. If the responsibility of managing the corporation fell on a single executive officer, his salary must be very large. As it is the five members of the Executive Committee receive $40,000 a year each or in all $200,000. His subordinates in authority would require at least $30,000 more, and the heads of departments another $20,000 so that the actual salaries of management would aggregate something like $250,000. Men who are in the sole leather business have told the writer that they would not consider starting a new tannery unless with an expectation of at least 9 % on the capital invested, — aside from the expenses of superintendence and management. This would make the risk about one-twentieth (4 % for pure interest and 5 % for risk). The few statistics at hand seem to indicate that there is considerable instability in the business, caused largely by the long period required to tan hides. This estimate of a risk of one-twentieth seems, therefore, fair. Under these circumstances, the economic profit of the United States Leather Company ought to have been $3,250,000. (Risk $3,000,000; salaries $250,000.) The net earnings, after depreciation, for the twelve and two-thirds years averaged $3,296,000. The pure interest during this period amounted to approximately 4 %, or would call for $2,400,000 per annum. The economic profit, during the period in question, amounted to $1,150,000. (Average net earnings $3,296,000; less pure interest on actual capital investment, $2,400,000, equals $896,000; plus salaries of management ($250,000) gives economic profit of $1,146,000.) The economic profit should have been nearly

equilibrium is the natural condition and the level toward which all enterprises move, and in this sense economic failure is merely an incident to adjustment. A corporation which started to manufacture bicycles in 1895 could not have been an economic failure, because even negative business ability of a marked character would not have prevented the company from earning profits, corresponding to positive ability, such was the excess of demand for bicycles over the supply. As the industry became standardized profits tended to distribute themselves in accordance with the risk and the ability of the management. Finally, owing to over-supply, every manufactory of bicycles became an economic failure, and could not yield a return on even the most positive business ability. The swings from over-success to economic failure bear almost entirely upon the profits because the existence of fluctuations creates the risk and the administration of this risk creates the necessity for business ability.[1]

three times as great. The United States Leather Company was, therefore, an economic failure. It never became insolvent, in the legal sense, because its capital liabilities bore no fixed charges. It was, however, just as much an economic failure as a business enterprise, as if its promoters had stifled its life with heavy fixed charges, and it had passed into the hands of receivers in the first year of its history.

[1] I am perfectly well aware that this statement is not in accord with the belief of many economists who give to both wages and interest a more significant position than I have done here. The present discussion is based on the presupposition that wherever the risk element occurs its presence brings into being entrepreneur ability, and the return can only be regarded as profits. When, therefore, because of fluctuations in the demand and supply of labor, wages in any given case or at any one time are above a theoretical normal, the margin is true positive profits; it is balanced off by an opposite margin which is true negative profits. As these tend to be equal, through a balancing of the fluctuations in the demand and supply of labor, there is no entrepreneur ability compensation, no profits, in normal wages. If, in the long run, any unit of labor secures a positive increment over and above the normal equilibrium wage, that unit of labor has exercised true entrepreneur ability in assuming the risks incident to employment in an unbalanced industry, and the increment will represent true economic profit. The presumption applies also to gross interest. Only with interest there is always some positive compensation to risk owing to the uncertainty of the immediate liquidation of the specific capital goods that form the basis of the interest payment. The risk of taking gross interest at a particular margin of risk, — the risk of the risk, — yields positive profits if above the normal of what the particular risk is worth, negative profits if below. Entrepreneur ability here consists of securing positive profits greater than negative. It is securing the risk of the risk, in the long run, for less than its absolute probability value.

CHAPTER XXII

Reorganization Expedients

1. The Problem of Reorganization.
2. Methods of securing temporary relief.
3. Methods intended to bring permanent relief to the corporation.
4. Summary of expedients.

1. *The Problem of Reorganization*

Reorganizations resulted from the efforts to rehabilitate corporations after a serious crisis in their affairs. The crisis was usually of a financial nature and the rehabilitation consisted chiefly in applying paliatives. Omitting from the generalization such reorganizations as those of the American Glue and the American Bicycle Companies, all the cases studied here show financial failure due directly or indirectly to the deflection of too much money from working capital to interest and dividends. The crises occurred when the corporations could no longer carry their accumulated loads, and were relieved when the loads were taken away. The burden was permanently removed when such readjustments were made that bond interests and dividends ceased to absorb so large a percentage of current earnings. Reorganizations, therefore, looked first toward the temporary relief of the company and secondly, but no less importantly, to the permanent removal of the source of trouble. In each of the reorganizations studied there were these two ends to be attained.

The essential element of every reorganization plan was that it should relieve the company of temporary distress. Usually the causes were long standing, although their serious consequence had been realized only a short time. Industrial corporations having no bonds always found it comparatively easy to negotiate loans at banks. The management could, therefore, authorize a relatively large amount of outstanding notes without creating

unfavorable comment from the board of directors or from the banks. The tremendous amount of notes outstanding at the time of the National Cordage Company's receivership is an illustration of this point. If there was a relatively small bond issue and the merchandise carried by the corporation was readily appraised and marketed, as is raw cotton for instance, the corporation would ordinarily experience little difficulty in negotiating notes. It is not surprising, therefore, considering the tendency of early managements to follow an unconservative policy regarding interest and dividends, and the willingness of banks to purchase the corporation's notes, that a heavy load of floating debt often accumulated before anyone fully realized its significance.

This heavy load of floating debt quickly brought about a crisis in the company's affairs. This might be occasioned directly by a crisis in the general financial situation, as the panic of 1893 precipitated the National Cordage failure, and that of 1907, the Westinghouse failure. It might be a crisis in the company's own management, as the unwillingness of the Bethlehem Steel Company's Directors to longer support the weaker shipbuilding yards directly precipitated the failure of the United States Shipbuilding Company, and the rise in the price of raw cotton caused the confession of the New England Cotton Yarn Company's difficulties. But in each case, as inherent lack of earning power invariably lay at the root of the increasing floating debt, and the germs of the trouble had been present for some years, the management had each time allowed the plants to lapse into poor physical condition; so that in addition to the heavy floating debt, the distressed company was suffering from under maintained and antiquated equipment, giving relatively high costs of production. When the directors came to a full realization of the conditions that confronted them, they looked about for assistance. This was the point where failure became imminent and reorgan zation necessary.

The relief had to come immediately for the weight of difficulties was usually upon the company before it could be foreseen. In the majority of cases, the serious character of the trouble

was not known by the business world. Sometimes even the board of directors had little intimation of the impending trouble,[1] as the president and one or two executive officers were the only persons fully acquainted with the actual conditions of the business. Quite frequently the bankers, who ordinarily negotiated the company's notes, were the first outside parties to suspect trouble.

The character of the action taken in response to the crisis depended upon the width of holdings of the company's securities, and the amount and kinds of securities already issued. If the stockholders were comparatively few, plans of reorganization were announced almost before the general public was informed of the company's distress. In this way much unpleasant notoriety could be avoided. Such a policy was followed in the first reorganization plan of the United States Shipbuilding Company, and in that of the United States Cordage Company.[2] If all the securities were very closely held, the reorganization was consummated without attracting further attention. This was certainly desirable, for the more unfavorable notice the company received, the greater the permanent injury to its credit. But experience has shown it to be almost impossible to effect a quiet reorganization. In order to remedy the inherent difficulties in the corporation's affairs, sacrifices must be made by the holders of securities, and security holders will not make sacrifices unless they are fully acquainted with the necessity and given an opportunity to express their opinions. In both of the instances mentioned above, committees of stockholders, who considered themselves aggrieved, arose and demanded a

[1] Some of the directors of the National Cordage, Westinghouse, American Malting, National Asphalt, United States Realty, the New England Cotton Yarn Companies, to mention only a few cases, did not know of the serious trouble confronting their corporations until almost the time of the public announcement of difficulties. Sometimes prominent directors granted interviews a few weeks before the crisis in which things were said which misled the public. These reassurances were usually due not to deception but to ignorance. It should be remembered that many directors are too busy with other affairs to follow accurately the condition of every corporation which they are supposed to direct. They depend on statements of officers, frequently tinged with unwarranted optimism.

[2] *Supra*, pp. 501 and 152.

full explanation of the causes of the trouble. In the Shipbuilding case, there resulted prolonged and disastrous litigation, which seriously injured the Bethlehem Steel Corporation. In the Cordage case, two plans were put forward and discussed, the reorganization was delayed and the misfortunes of the Cordage consolidation were widely talked of much to the detriment of its credit. In brief, a quiet reorganization, put through without attracting unfavorable comment to the company, has usually been impracticable.

A reorganization without involving direct sacrifices of the security holders could sometimes be made without attracting much unfavorable comment. If the corporation had paid dividends on its stock for a considerable period of time, if its securities had a high standing in the investment market, it sometimes appeared to the Board of Directors that the immediate difficulties could be averted by the issue of new stock on an attractive basis. This was usually the plan adopted if the need for more money could, by any stretch of the imagination, be attributed to a plethora of new business. The three notable instances in which the plan of issuing stock was tried, as the clouds began to thicken, all proved failures. The National Cordage Company offered new preferred stock at its par value, — the old was then selling well above par, — about two months before its insolvency. Instead of helping matters, the attempted sale precipitated the crisis because the new issue was interpreted by the speculators as a sign of hidden weakness. In the first Westinghouse reorganization, too, a new stock issue was offered to stockholders on very favorable terms about six months before the reorganization. It was a practical failure, and brought in an amount of new capital that was insignificant when compared with the floating debt. In the second Westinghouse reorganization, new stock was again offered about six months before the failure. Few stockholders subscribed and the small amount of new cash obtained was again of inconsiderable assistance to the Company. In the majority of the cases of reorganization described the offering of a new stock issue for voluntary subscription would have been markedly inexpedient. No sub-

scribers would have come forward and the confession of weakness would have injured the chances for a more successful reorganization. The mere fact that the plan failed in the three instances mentioned, when the corporation was in each case presumably perfectly solvent and its securities on an investment plane, seems to show that little confidence can be placed in the voluntary subscription to new stock in the face of a threatening crisis.

When neither a secret reorganization nor the voluntary subscription to new stock proved practicable, the management was compelled to confess the weakness of the corporation. Immediately one or more committees arose, usually self appointed,[1] which finally proposed a plan for rehabilitating the finances of the corporation. This plan invariably had in view those two major purposes mentioned earlier, — provisions for new capital and provisions for the permanent relief from the conditions that were believed to have brought on the crisis. As these two purposes lead to distinctly different methods of treatment, they will be discussed separately.

2. *Methods of Securing Temporary Relief*

The immediate necessity of every plan of reorganization, — not consummated mainly for extension of control, — was a provision for supplying new capital with which to fund the floating debt. This was accomplished in one of four different ways. The money was contributed (1) by outside bankers who purchased bonds or notes on liberal terms, (2) by the stockholders alone, (3) by the bondholders with perhaps partial

[1] The membership in these committees is sometimes sought after because of the usually liberal compensation for merely nominal services. Quite generally, a secretary or the "attorneys to the reorganization committee," do the actual work and even formulate the plan of reorganization. The members often merely attend meetings and give moral support to the work of their attorneys. Officers of prominent banking firms and institutions seek or are sought for these positions. In the resulting plan of reorganization compensation for its services is very carefully guarded by the committee. On the other hand, some committees, like that of the second Westinghouse reorganization, devoted time and labor unsparingly to the rehabilitation of the corporation.

assistance from the stockholders, (4) by the holders of the floating debt acting either independently or with the assistance of outside bankers. It sometimes happened that some assistance came from two or more sources, as in the case of the first Westinghouse reorganization when the new capital was supplied by independent bankers and the stockholders, while the holders of the bank debt and the merchandise creditors funded their claims into preferred stock. In the recent Westinghouse reorganization the same expedients were resorted to a second time. Generally speaking, however, the four methods for obtaining new capital were relatively distinct from each other, each being resorted to as the response to a special set of conditions.

The simplest and, from many points of view, the easiest method of procuring capital in an emergency was to sell securities to outside banking houses, which would in turn offer them to the public. This method had the great advantage of not creating the necessity for individual stockholders to act. And although the sacrifice was theirs, as the new securities were placed ahead of their stock, this sacrifice came in the form of the lessened market value of their shares and not in any direct contribution. Their consent could, therefore, be very easily obtained especially if it could be alleged that the new capital would, in any way, increase the permanent earning power of the corporation. So, at least, it has been with the companies here under discussion.

The difficulty of this method lay usually in the difficulty of finding bankers who would come forward and risk their funds and their more valuable reputation in an enterprise which was approaching or on the brink of insolvency. It was only when the financial emergency which the bankers were asked to relieve could be traced to a clearly defined cause, against which safeguards could be in the future provided, that the bankers were willing to lend their assistance. The reorganizations which were accomplished through the aid of independent bankers were, therefore, those of the least serious kind, as when a tightening of the money market, a sudden fall of prices, or the immediate need of new machinery had caused a temporary emergency not likely to recur again.

The form of the security sold to independent bankers varied somewhat according to the markets, but was ordinarily of the type of prior lien bonds or short term notes protected from the further issue of prior lien obligations.[1] Such securities could be more easily marketed by the bankers than either debenture bonds or stock. The most familiar form of security to be issued to meet an emergency of late years, — especially since 1907, — has been the short term note,[2] but during the period when the majority of the reorganizations studied here took place, this form of security was little used. Ordinarily when an early issue of bonds was resorted to in order to retire a troublesome floating debt, there were no previously existing funded liabilities. The first reorganization of the American Malting Company is a good instance of such a case. It followed the publication of the Uhlmann report in which the irregularities of accounting were described and the statement made that the credit of the company had fallen so low that new loans could not be obtained. This statement was made after it became clear that an original fund of working capital of $2,000,000 had been changed to a floating debt of $3,000,000. From the difficulties arising from these revelations, the Company extricated itself by the issue of $4,000,000 in bonds, a move possible only because the corporation had been organized without funded debt, and the value of its plants was well above the face of the new bond issue. Sometimes, as in the case of the United States Leather Company, the charter forbade an issue of bonds. But ordinarily if the corporation stood without funded debt, an early issue of bonds to retire a rapidly maturing floating debt of unmanageable proportions would afford the Company the desired relief. Had such a measure been legal it would have rendered unnecessary

[1] Like the three year 6 % convertible notes of the International Cotton Mills Corporation (New York) which were protected by a covenant that no mortgage or other incumbrance could be placed on the Company's mills while the notes were outstanding.

[2] Witness the plethora of short term notes issued by railroad and industrial corporations in 1907–08, and again in 1913. During the late spring months of 1913, they were practically the only means of financing adopted by all the large corporations then in need of money. Of course not every issue indicated financial trouble but every issue did indicate "emergency financing" of some character.

the Leather reorganization and had it been resorted to sufficiently early, it would have prevented both crises in the history of the Westinghouse Company. It might perhaps have given the desired relief to the National Cordage and the Pope Manufacturing Companies.

Quite frequently, one might almost say usually, arrangements were made in which a part or a whole of the new securities underwritten or bought outright by the bankers was first offered to the old stockholders on what were intended to appear exceptionally favorable terms. The first mortgage bonds of the old American Malting Company were offered to the stockholders at 95%, having been underwritten by the bankers at 90%. At the time of the Pope Manufacturing Company's reorganization, the first lien notes were offered to the stockholders with a liberal bonus of common stock. In the case of the Malting Company's bonds, the stockholders failed to respond whereas practically all of the Pope Company's notes were acquired by the stockholders, so that little positive assurance can be placed upon the willingness of the stockholders to purchase the new securities. In every case, the bankers or the management sought to make it clear that the stockholders were securing the bonds or notes on exceptionally favorable terms,[1] so that the offering could in no sense be regarded as an assessment.

The table on the following page summarizes the provisions taken for obtaining new money in those reorganizations in which the required capital was furnished by independent bankers.

The method of raising new capital by contributions from stockholders, the second possibility, was resorted to when it seemed necessary to appeal to any security holders. It was apparently, too, the fairest to all concerned because in the end the stockholders alone were the owners of the business, and should

[1] For example, the Standard Gas and Electric Company (Delaware) having taken over some lighting properties in Louisville, Kentucky, sold short term, collateral trust notes in 1913. To encourage the interest of the stockholders, the management pretended to offer them the notes at a slightly lower price than that at which the public were asked to subscribe. Two months later the Directors declared the preferred stock dividend in ten year script instead of money, alleging as an excuse a variety of causes but not mentioning the fundamental cause.

REORGANIZATIONS IN WHICH INDEPENDENT BANKERS CONTRIBUTED MONEY

	Kind of Security Taken by Bankers	Was It a First Lien Security?	Amount of Issue Taken	Payment to Company		Compensation to Bankers	Form of Bankers' Compensation	Was Issue Offered to Stockholders
				Rate	Aggregate			
Westinghouse Electric and Manufacturing Co.; Same (1891)	Preferred Stock	Yes	$1,000,000	87½%	$875,000	$125,000 125,000	Money Preferred Stock	Yes
Pope Manufacturing Co.; Same	Short Term Notes	Yes	800,000	100%	800,000	500,000 90,450	Preferred Stock Common Stock	Yes, with Part of Bankers' Compensation
American Malting Company; Same	First M. Bonds	Yes	4,000,000	90%	3,600,000	$200,000	Money	At 95%
Mount Vernon Cotton Duck Co., U. S. C. D. C.	Preferred Stock	Yes	2,750,000	100%	2,750,000	3,100,000	Common Stock	No
Consolidated Cotton Duck Company; International Cotton Mills Corporation	Notes and Preferred Stock	Part	3,700,000	100%	3,700,000	2,700,000	Common Stock	Yes, Partially at Same Terms as Bankers
International Cotton Mills Corporation (N. Y.); Same (Mass.)	Notes and Preferred Stock	Part	12,850,000	80% 90% 100%	7,925,000	1,200,000 75,000	Common Stock Commission	Partially, at Same Terms as Taken by Bankers
National Asphalt Company; General Asphalt Company	Common Stock	Yes	4,500,000	50%	2,250,000	0		Yes
United States Shipbuilding Company; Bethlehem Steel Corporation	Bonds	Yes	3,000,000	87½%	2,625,000	none directly	....	At 87½%

bear the burden of losses as they would reap the advantage of profits.

The simplest form of stockholders' subscription was the mere surrender of a part of the holding without the contribution of new money. The stock thus surrendered was sold by the corporation for money or used to acquire other interests which gave sufficient added strength to enable the corporation to pass through the crisis. This was the method adopted at the first Westinghouse reorganization. The stockholders contributed no funds, but surrendered two-fifths of their shares, which were then made immediately available as treasury stock for sale to bankers and merchandise creditors. The same plan was followed in the reorganization of the National Starch Manufacturing Company where the stock surrendered was used to purchase the United Starch Company. It was employed later in the Corn Products Company's reorganization, when the old stockholders surrendered a third of their holdings in order to acquire the large competing plant of the New York Glucose Company with its high credit and abler management. A similar surrender of stock, without direct payment of new funds, was the main feature of the second Malting reorganization. Here the purpose of the sacrifice was merely to improve the Company's credit and reduce its capitalization. The table on the next page illustrates those reorganizations which were effected without money subscriptions by the stockholders, but which involved a surrender of a portion of the stockholdings.

The more ordinary method of securing assistance from stockholders was by a direct money assessment. This has been, of course, the familiar method resorted to in railway reorganizations, and, although not universally adopted, has become the customary practice in the reorganization of industrial corporations. In the vast majority of cases, stockholders do not voluntarily come forward with subscriptions of new money and the more serious the crisis the less willing they are to come to the rescue. Ordinarily considerable pressure has to be brought to bear to induce their response, and some individual pecuniary advantage has to be presented to them. In deference to this feeling it has

REORGANIZATION BY STOCK SURRENDERED BY STOCKHOLDERS FOR WHICH NOTHING WAS GIVEN

Reorganizations	Date	Percentage Stock Surrendered	Use Made of Stock
United States Leather Company. Common	1905	70%	Cancelled, Given to Preferred and to New Interests
National Starch Company	1902		
Preferred	...	5 %	Cancelled
Common	...	10 %	Cancelled
Westinghouse Electric and Manufacturing Company	1891	40 %	Sold by Company
Corn Products Company	1906	$33\frac{1}{3}$%	To Acquire Competing Interests
Standard Rope and Twine Company	1905	100 %	Issue Extinguished
United States Realty and Construction Company	1904	85 %	Cancelled
American Malting Company	1905		
Preferred	.	38 %	Cancelled
Common	.	56 %	Cancelled
Mount Vernon-Woodberry Cotton Duck Company	1901	$33\frac{1}{3}$%	Cancelled
United States Cotton Duck Corporation	1905	60 %	Cancelled
Consolidated Cotton Duck Company	1910	50 %	Cancelled
International Cotton Mills Corporation	1913		
Preferred	..	23 %	Cancelled
Common		$83\frac{1}{3}$%	Cancelled
United States Shipbuilding Company	1904	100 %	Issues Extinguished

been the universal custom to give the old stockholders new securities for their money assessment, but even then, it has been far from easy to persuade them to come forward with their contributions. Generally the new securities offered in return for money payments have been given some preferential advantage over the old securities, — or at least over the stock of those who refused to pay the assessment. Among our present cases there was one notable exception to this rule. In the second Westinghouse reorganization, the stockholders were invited to subscribe to the amount of one-fourth of their old holdings in common stock, but this stock was no wise different in lien or preference to dividends from the old common stock, nor were those who came to the rescue of the Company placed in any better position than those who failed to respond. The fact that there was some response to the plan was due to the well-justified feeling that the Westinghouse Company's stock was worth, in assets and earning power, its full par value.

Generally speaking, a reorganization which contemplated an assessment on the stockholders provided for the formation of a new corporation which should ultimately acquire the physical assets of the old corporation. This was usually considered essential in order to eliminate those of the stockholders who refused to bear their share of the burden.[1] It could only be resorted to when conditions were distinctly serious. The winding up of one corporation and the incorporation of another is expensive. Not only do the attorney's costs amount to a considerable sum, but the corporation loses the trade standing of an established name. Although the United States Leather Company passed out of existence some time ago, and all its assets were acquired by the Central Leather Company, still the old title was maintained by the subsidiary selling company because the name had become well known in the leather trade. Customers become accustomed to a business name and if the corporation's affairs are conducted in an honorable fashion it is not to the Company's advantage to change it. So that quite frequently, when it appeared to be necessary for a new corporation to be formed, the name was not changed, but a new charter for a corporation of the same name was taken out under the laws of another state.[2] Another disadvantage of a new charter, not so pertinent to industrial reorganizations as to railways, is the loss which comes with the legal winding up of a corporation, of privileges of an old charter or of advantageous leases and contracts.

In case, from every point of view, the judicial sale of the assets of a corporation seems necessary in order to force the stockholders to come forward, it is customary to have the subscriptions underwritten, for otherwise the whole plan might accomplish nothing except the extinction of certain interests without securing to the new corporation the needed funds. This underwriting expense is apparently necessary although frequently

[1] The second Westinghouse reorganization again forms an exception to the rule.

[2] Pope Manufacturing Co. (N. J.) became a Connecticut corporation.
New England Cotton Yarn Co. (N. J.) became a Massachusetts corporation.
International Cotton Mills Corp. (N.Y.) became a Massachusetts corporation.

a heavy drain, as it generally amounts to at least 10% of the new cash supplied. Thus the members of the syndicate managed by Kidder, Peabody and Company in the New England Yarn reorganization received a commission of 5% for their subscriptions and the managers another 5%. The risk is sometimes considerable, and losses like that of the Sheldon syndicate of the Shipbuilding Company, and the Hallgarten syndicate of the Realty Company are by no means unusual. In such cases the compensation was perhaps none too much, but in the majority of instances, where the reorganization was so drastic that the new securities were of assured value, the risk was comparatively slight and the commissions to the banking houses seem disproportionately large. At all events, they were a direct load on the new corporation of which the stockholders obtained only an indirect benefit. A better policy for the reorganization committee to adopt was that of paying the bankers in stock of the new company, so as to assure the continued interest of the banking house based on distinct personal advantage. See table facing page 596.

The table on the following page shows those reorganizations in which money subscription was forced from the old stockholders through the sale of the assets of the old corporation to a new corporation formed for the purpose. In the table are included cases in which the bondholders coöperated with the stockholders, but a detailed discussion of this aspect is given later.

The third method for securing temporary relief was through the forced subscription of bondholders. This method was applied only to corporations having a considerable funded debt, and then only when their financial difficulties were comparatively serious. It was the only alternative open, when the stock of the company had become worthless on the market. In such a case, the equity had become almost valueless and the shareholders, having nothing to lose through the bankruptcy of the corporation, could not be expected to provide adequate relief. The bondholders alone had then a real interest in the property of the corporation, and were forced to put their shoulders to the wheel if they would preserve any value to their securities.

REORGANIZATIONS WHERE STOCKHOLDERS WERE ASSESSED

Corporation Reorganized	Cash Subscriptions and Securities Given for Stockholders										New Securities (given to assessed stockholders) for Assessment					
	Was a New Company Formed	Was There a Judicial Sale of the Assets	Preferred Stock				Common Stock				Bonds		Preferred Stock		Common Stock	
			Perc. of Old	Amount of Stock Surrendered	Perc.	Amount of Assessment	Perc. of Old	Amount of Stock Surrendered	Perc. of Old	Assessment	Perc. of Assess.	Amount	Perc. of Assess.	Amount	Perc. of Assess.	Amount
			%		%		%		%		%				%	
National Cordage Company; United States Cordage Company	Yes	Yes	...	....	20	$1,000,000	..	. ..	10	$2,000,000	.	....	100	$3,000,000		
United States Cordage Company; Standard Rope and Twine Co.	Yes	Yes	20 60	$1,200,000 4,800,000	20 10	1,200,000 800,000	80	$16,000,000	5	1,000,000	100	$3,000,000				
Westinghouse Electric and Manufacturing Company; Same	No	No	....	....	..	. ..	.	. ..	25	6,000,000	..	....	..	....	100	$6,000,000
American Bicycle Company; Pope Manufacturing Company	Yes	Yes	50	4,650,000	9	837,000	75	13,276,000	9	1,593,000	..	....	100	2,430,000		
New England Cotton Yarn Company; Same	Yes	Yes	30	1,500,000	30	1,500,000	92	400,000	10	500,000	..	....	100	2,000,000		
National Asphalt Company; General Asphalt Company	Yes	Yes	89	7,123,332	44	35,216	96	11,089,508	16	18,482	..	....	.	. ..	..	1,342,474

In these cases, it is obvious that the worse the affairs of the corporation became, the more its bondholders were concerned with its reorganization. Needless to say, also, that reorganization in such cases was accomplished, almost invariably, through the winding up of the affairs of the failed corporation, and the judicial sale of its assets to a new one owned principally, if not entirely, by the old bondholders. But even in a case in which there was practically no equity left to the shareholders, and when the whole reorganization was arranged by committees formed from the holders of the funded debt, it was customary to give the old stockholders a chance to preserve an interest in the new corporation through the payment of a considerable assessment. In only three instances were the old stock interests entirely extinguished out of the twenty-four reorganizations discussed in this book. In these three instances, the Standard Rope and Twine Company, the Pope Manufacturing Company and the United States Shipbuilding Company, the securities were worthless on the market and the slightest acquaintance with the facts showed that the shareholders had no just claims to any of the property of the corporation.

When sacrifices were necessary from the bondholders, the ease with which the reorganization could be consummated depended somewhat upon the number and amount of the issues of funded debt. When there was but one mortgage on the property, and that equal if not greater than the assets, the assessment or other sacrifices were usually distributed evenly among the bondholders. A foreclosure and subsequent judicial sale of the property was necessary in order to eliminate the old stock interests, and the bondholders who refused to bear their share of the burden. These latter were paid off in accordance with the price received at the foreclosure sale, but as this price was usually low compared with the face value of the bonded debt, those of the bondholders who refused to participate in the reorganization were paid a relatively small percentage of the value of their securities. Thus in the Asphalt reorganization, those holders of the old Asphalt Company of America's bonds, who did not exchange them for the preferred stock of the General Asphalt Company,

received only 11% of their par value.[1] The policy in most reorganizations has been to make the plan of exchange of securities so attractive that the claims to be met by payments of money were as small as possible. No general principles can be laid down concerning the kind of securities given for the money subscribed by the bondholders. If the lien they already had was a first mortgage, they could be given nothing better in exchange for their subscriptions. Thus in the United States Shipbuilding final plan, the first mortgage bondholders were allowed to subscribe to the new bonds, while their old first mortgage bonds were refunded into preferred stock. Again, in the Standard Rope and Twine reorganization, the money subscribed by the bondholders represented no lien superior to that of the old bonds. If, on the other hand, the old funded debt was not secured by a first lien on the property, it was usual to give a first mortgage for the new money subscribed, as in the case of the National Cordage reorganization. Such a practice was not, however, the universal custom, especially if the failure was serious. In that case the old bonds are pushed back to a second preferred or to common stock, and preferred stock given only for the money subscriptions. This was exactly the plan adopted in the reorganization of the unfortunate American Bicycle Company.

When there was more than one kind of funded debt, the problem of the just distribution of the responsibilities was no easy one to solve to the satisfaction of all interests. In the first plan of the reorganization of the United States Cotton Duck Company, the decisive problem was to determine the relative rights of the first mortgage bondholders and income bondholders of the Mount Vernon-Woodberry Company and the holders of the first lien on the United States Company's mills not included in the Mount Vernon group. The plan failed utterly because these three interests could not agree on a division of the sacrifices necessary to obtain a harmony of interests. In cases where the prior liens were unmistakably less than the actual assets of the business it was customary to allow them to

[1] *Supra*, p. 460.

remain undisturbed. This was done quite generally with small first mortgage issues, even when the junior security holders were compelled to make considerable sacrifices. The position of the Trinidad Asphalt Company's first mortgage bonds in the drastic reorganization of the asphalt companies and the underlying bonds of the Bethlelem Steel Company are instances in point. The following table shows the cases in which the bondholders were the chief factors in extricating the company from its failure. It should be remembered, however, that in nearly every case some money was furnished by the stockholders also, and for purposes of comparison this is added in the table.

The fourth method of securing temporary relief from a heavy burden of floating debt was to shift the responsibility from the security holders to the creditors of the corporation. The creditors were bankers either acting for themselves as holders of the floating debt, or in coöperation with the merchandise creditors. Just as recourse to the bondholders was taken only after it seemed as if the stockholders were unwilling to relieve the situation, so recourse to outside creditors was had only when the crisis in the affairs of the corporation was so serious that the stockholders and bondholders together were unable to accomplish a reorganization. In this situation, the outside creditors had usually the alternative of either liquidating the affairs of the corporation, which usually meant that they would realize only a portion of their claims, or else taking hold of its affairs and reorganizing the corporation themselves. The latter alternative was almost always [1] taken as the creditors, by threatening to wipe out one or another class of security holders, were able to obtain some help from them. If the property of the corporation was valuable, as that of the Westinghouse Company after its second failure, the creditors were in a position to carry out

[1] The only exception in the previous historical accounts was the final liquidation of the Standard Cordage Company by its bondholders in 1912. Such liquidations are very rare in every class of reorganization. Among railroads they would be most common under equipment mortgages or deeds of trust owing to the movable and readily salable character of the assets securing the obligations. Yet the present writer knows of but a single instance, that of the Detroit Southern Railway, where the security was actually taken and sold.

REORGANIZATIONS INVOLVING SACRIFICES BY BONDHOLDERS

Reorganizations	Amount of Old Bonds	Amount of Old Stock	Assessment on Bondholders		Security Given for Assessment on Bonds	Was Security Given for Assessment a First Lien Security	Security Given for Old Bonds	Percentage of New Security to Old Bondholders	Was Security Given for Old Bonds a First Lien Security	Security Given for Old Stock
			Percentage	Amount						
			%					%		
National Cordage Company; United States Cordage Company	$6,000,000	$25,000,000	. . .	. .	No Assess.	. .	1st Pref. Stock	100	No	2d Pref. and Com. Stocks
United States Cordage Company; Standard Rope and Twine Company	6,750,000	34,000,000	.	. . .	No Assess.	. . .	Income Bond	100	No	Com. Stock
Standard Rope and Twine Company; Standard Cordage Company	9,545,330	12,000,000	26 5	$719,250 357,280	Mort. Bonds	Yes	Income Bond	Var.	No	Extinguished
American Bicycle Company; Pope Manufacturing Company	9,150,000	27,000,000	. . .	. . . .	No Assess.	. . .	2d Pref. Stock	100	No	Com. Stock
Mt. Vernon-Woodberry Cotton Duck Corporation; Consolidated Cotton Duck Corporation	6,000,000	Not Considered	. . . .	. . . .	No Assess.	. . . .	Preferred Stock	50	No	
Asphalt Company of America; General Asphalt Co.	29,432,255	. . .	. . . .	. . . .	No Assess.	. .	Pref. Stock	50	Yes	
National Asphalt Company; General Asphalt Co.	6,000,000	19,555,314	1.6	95,816	Com. Stock	No	Com Stock	40	No	Com. Stock

the reorganization in accordance with their own plans. If they had, as in the National Cordage case, liens on specific quantities of material, their position was even more secure, and they were able to exact, not infrequently, onerous terms from the unsecured creditors and bondholders. Few instances have existed in which the corporation was in such straits that the creditors were the only interested parties. Long before this condition was reached the corporation had probably issued mortgage after mortgage, and the senior bondholders had nearly always something to preserve. When the creditors were the chief factors, the plan usually took the form of a compromise. The holders of the senior securities, besides sacrificing something of the par value of their bonds, contributed money to be used in rehabilitating the business. In consideration of this concession the creditors usually consented to fund their debts. The difficulty arose in the adjustment between the liens of the securities issued for the bondholders' money, and those issued to fund the debts of the creditors.[1] An adjustment of this difficulty depended largely upon which interest was fortunate enough to hold the whip hand. If the bondholders were secured by a first mortgage on essential real estate, they were in a position to exact preferential terms, whereas if the creditors were secured by liens on specific quantities of merchandise, they were in relatively the stronger position, because of the greater ease in marketing their security. The following table illustrates the distribution of securities when the outside creditors accepted new stocks or bonds for their debts.

In all reorganization plans the immediate relief of the corporation was secured from one or more of the important sources just summarized. If the crisis was not serious, the management could secure aid from bankers; or the stockholders were willing to contribute all the necessary funds, although they might require that the holders of funded debt should make sacrifices in-

[1] In the case of the United States Cordage reorganization, the old first mortgage bonds drew back to income bonds, on condition that all classes of stockholders should contribute money to fund the floating debt. These same first mortgage bonds represented part of the securities given to pay the large unsecured floating debt in the first reorganization.

REORGANIZATIONS INVOLVING SACRIFICES BY OUTSIDE CREDITORS

Reorganizations	Date	Amount of Creditors' Claims	Amounts of Bond-holders' Interests	Amount of Stock-holders' Interests	Amount of Debt Subscribed by Creditors	Securities Into Which Creditors' Claims are Funded	Con-tributions by Bond-holders in Money	Securities Given for Bond-holders' Cash	Con-tributions by Stock-holders in Money	Securities Given for Stock-holders' Money
Westinghouse Electric and Manufacturing Company	1891	$3,303,611	....	$6,800,000	$2,000,000	Preferred Stock	No Bonds	No Bonds		
	1907	14,241,762	$30,000,000	28,000,000	11,500,000	$3,500,000 Bonds 1,500,000 long Notes 6,500,000 Com. St.	....	....	$6,000,000	Common Stock
National Cordage Company; United States Cordage Company	1893	12,600,000	6,000,000	25,000,000	7,000,000	6,000,000 Bonds 1,000,000 Notes	....	....	3,000,000	2d Pref. Stock

volving a lessening of their principal or interest. If the crisis was more serious, the reorganization might be undertaken by the bondholders who might enlist the help of the stockholders on the promise of some stock interest in the reorganized company. If the crisis was very severe, involving a serious business failure, the holders of the floating debt were compelled to take the principal part in the reorganization. In that case the old security holders were allowed to acquire an interest in the new business on the payment of a considerable assessment. The adjoining table illustrates all the various reorganizations considered, in which the subscription to new capital was an important feature.

3. *Measures Intended to Bring Permanent Relief to the Corporation*

The attempt to relieve the immediate distress of the company was always the initial step in any reorganization, but it did not relieve the causes which brought about the crisis. Recognizing this fact all those concerned with the reorganization understood the imperative necessity of accomplishing a more thorough readjustment than that involved in the mere temporary relief of the burden of debt. Reorganization committees in planning to remove the causes of distress have ascribed these causes to one or both of two different sets of conditions,—(1) trade conditions, involving over-production and disastrous competition (2) errors of capitalization, involving excessive payments in fixed and contingent charges. These two fundamental causes are radically different and require separate consideration.

Many reorganizations have been brought about very largely in order to reduce competition. This was the direct purpose of the Starch Manufacturing Company's reorganization in 1898, and the subsequent amalgamation of the National Starch and the Glucose Sugar Refining Companies. In fact it may be said to have been the underlying motive for all the reorganizations of the starch and glucose consolidations. It was one of the chief purposes in the first Mount Vernon-Woodberry Company's refinancing in 1901, and in the Asphalt Company of America's reorganization in 1900. It was a minor purpose in several other

organizations where the hope of a better control over the market added a stimulus to further investment of capital.

Reorganizations which intended to suppress competition have not, for legal reasons, thrown this purpose into the foreground. The object has been indirectly stated by mentioning the evil results of over-production and low prices, and by contrasting the percentage of the industry that the new corporation would be expected to control with that controlled by the old. As indicated by the promotion prospectus, experience has shown that the ordinary investor believed readily in the fallacy that the larger the apparent percentage of control in an industry, the larger the profits through monopoly prices. The price policy of many corporations shows clear signs of its influence. It was a common practice among many of the industrial consolidations, especially those formed before 1899, to raise the price of their products, on the expectation of being able to control the industry. In almost every instance, the policy operated to the disadvantage of the corporation, for the management soon found itself confronted, at every turn, by new competitors attracted to the industry by the high level of prices and the apparent liberal margin of profits. These new manufacturers could further take advantage of improved technical processes and so make their manufacturing costs as low or even lower than those of the large consolidations. The management of the old Starch Manufacturing Company's mills, for illustration, was outgeneraled at every point, till the trade gradually slipped away. When the Mount Vernon-Woodberry Cotton Duck Company sought, in its earlier years, to maintain prices at an artificial level, cotton mills all over the South were refitted as duck mills. The National Cordage Company stimulated outside production in its efforts to inflate the prices of both hemp and cordage. The history of the Asphalt business in this country, up to and including the formation of the National Company, was the history of one continuous effort to maintain artificial prices through the suppression of competition by purchasing the new enterprise that bore the signs of promise.[1]

[1] The observations of Chairman A. W. Green in the Annual Report for the National Biscuit Company for 1901 are interesting to the student of economics.

In an industry where an abnormal level of prices was maintained by the help of either the tariff or basic patents, like the plate glass industry on the one hand and the aluminum industry on the other, the policy of suppressing competition might prove successful in the long run. The chances, even with these favoring conditions, however, were against success. Public sentiment has long been incited against a tariff that enabled an industry to thwart economic laws, and has frowned upon the perpetuation of a monopoly by long enduring patent processes. When, on the other hand, as with these cases now under analysis, a corporation with even a large control of an industry tried to maintain an artificial level of prices without the assistance of the tariff or other special advantages in its favor, the policy defeated its own end. Capital flowed easily in the direction of the greatest margin of gross profit, on the well-established belief that an abnormally high rate of return indicated that the supply was less than the demand.[1]

" When the Company started it was believed that we must control competition, and that to do this we either fight or buy it. The first meant a ruinous war of prices, the second constantly increasing capitalization. Experience soon proved to us that instead of bringing success, either of these courses, if persevered in, must bring disaster. This led us to ask ourselves whether the Company, to succeed, must not be managed like any other large mercantile business. We soon decided that within the Company itself we must look for success."

" We turned our attention and bent our energies to improving the internal management, to getting the full benefit from purchasing our raw materials in large quantities, to economizing the expense of manufacture, to systematizing our selling department, and, above all things to improving the quality of our goods. It became the settled policy of this Company to buy out no competition, and to that policy, since it was adopted, we have steadfastly adhered and expect to adhere to the end."

[1] Every large business is in a position to be " held up " by an unscrupulous promoter who builds a factory and starts an advertising campaign in order to induce the directors of the corporation to " buy him out." This was done in the early days of railroading, when a cheaply constructed branch line would be built in order to induce the directors of the main line to acquire it under exorbitant conditions. The late John Murray Forbes called these " cats' tails " when presented to the old Chicago Burlington and Quincy Railroad, because, when in the past he had offered a bounty on cats if killed on his Island of Naushon, cats' tails were brought in from the mainland and the bounty claimed. Latterly, directors of corporations have shown a healthy reluctance to become tools to such projects and the promoters have found themselves with unlooked for protegés on their

As competition grew, one of two measures was open to the large corporation. It could continue to maintain prices at an artificial level by absorbing all the surplus supply at the artificial price,[1] or it could cut the prices in hopes of extinguishing competition.[2] When the former policy was adopted, there came finally a point beyond which the corporation could no longer absorb the surplus. It was already overloaded, and the precipitous drop in prices which occurred when it withdrew its support demoralized the market, and hurt the large corporation most because of its large holdings. This was exactly the history of the National Cordage Company. For two years and a half, the Company maintained an artificial level of prices for both hemp and cordage. When the panic of 1893 came bankers were unable longer to carry the accumulated load of notes brought about by the heavy purchases of material and the National Company failed. Its stock of hemp and cordage was finally sold for less than half the cost. If the corporation adopted the opposite policy of cutting prices below cost, in retaliation against the new competitors, it again suffered most, for its sales were largest. The new competitors, who could produce their goods more cheaply because of more modern plants, had an even more marked advantage. This was shown in the history of the Corn Products Company.

In the presence of increasing competition the large corporation failed to perceive that its own price policy was a source of

hands. A large sugar refinery near New York was built on the expectation of its resale to the American Sugar Refining Company. The latter had, many times before, bought out new competitors at fictitious prices. But a change of policy on the part of the American Company left this particular refinery in the hands of its promoters who had to practically rebuild it in order to run it. An episode in the history of the American Chicle Company is instructive in this respect. The Company was organized by Mr. Charles R. Flint in 1899. It acquired control of the well-known brands of chewing gum and considered its position secure. One Wrigley, of Chicago, commenced a nation-wide exploitation of a new brand of chewing gum. The audaciousness of the plan took the officials of the American Chicle Company unaware. Presently, Wrigley offered to dispose of his rapidly growing business for several million of dollars in bonds. This offer was refused, but later negotiations were opened on the basis of twice the original figure. The American Chicle Company's Directors refused to consider the proposition.

[1] Like the National Cordage Company.

[2] Like the Asphalt Company of America.

its diminishing strength, and sought to explain its lessened trade position on the ground of over supply and adverse trade conditions. In the vain effort to fortify the wall of their intended monopoly, the directors looked about for further props; they gave credence to the fallacy that financial distress was the direct result of increased competition. As a result, the corporation was reorganized so as to include the more active and enterprising competitors. Not infrequently the new interests, having been successful in competing with the large corporation, assumed actual control of it in its new form. This was the case when the Bedford management took into its own hands the control of the Corn Products Refining Company, when the Mack management took control of the Asphalt Company of America, and the Jackson-Greene management became dominant in the International Cotton Mills corporation. Generally speaking, the reorganized corporation, when its control was assumed by able men who were previously its most successful competitors, was more benefited by the new business ability than by the acquisition of new plants. Quite frequently the price policy was changed, and instead of endeavoring to thwart economic laws by seeking to sell goods at monopoly prices, the new management, schooled in the benefits of competition, sought to control the market by the sale of products on the lowest possible margin of profit. The Corn Products Company and its precedessors sought for years to maintain high prices in the Starch and Glucose industries and failed. Not the least of the sound business policies adopted by the Bedford management, after the reorganization of the Corn Products Company, was that of the sale of starch and glucose at prices that showed the lower margin above manufacturing costs. The Corn Products Refining Company grew strong under low prices, whereas its predecessors had grown weak under high prices.[1]

[1] As wise business policy may be gleaned better from success than failure, the statements of two of the most successful industrial combinations may be noted.

President Nichols, in his first report to the stockholders of the General Chemical Company, stated, "It is the fixed policy of the Company to depend on the economies and improved methods of manufacture rather than increasing the cost to the consumer. It is believed that adherence to this policy will, in the long run, produce the most satisfactory results." 1900 G. C. Co. Rep. 1.

The following tables indicate the results of those reorganizations consummated mainly, if not entirely, to absorb competitors.

Although many corporations were reorganized in order to extend their control, in the expectation that a monopolistic position in the industry would insure large profits, the hope of permanent success, in the vast majority of reorganizations, lay in the reduction of interest and preferred stock dividend payments. It was pointed out in the previous chapter on the causes of crises that in a large majority of cases financial disaster resulted directly from attempts to meet too heavy charges. These might have been in the form of interest or dividend, but the result was the same, — the accumulation of a heavy load of floating debt. To obviate this drain, plans of reorganizations have wisely provided that the burden of charges on the reorganized company shall be reduced. Sometimes reorganiza-

The experience of the American Radiator Company, following the same line of reasoning, is even more striking, considering the fact that the American Radiator Company has been one of the best if not the best managed of the various industrial combinations. A depression in trade has been presumed to affect first and most seriously those industries directly concerned with building operations. One would presume, further, that the sale of improved heating appliances would be seriously curtailed during a business depression, — particularly during the panic of 1907 and the following months of depression.

The following extracts from the report of the American Radiator Company for the year ending March 3, 1909, a year of depression throughout the country, is a remarkable commentary on the efficiency of management in preventing fluctuations in earning power.

"Building operations throughout the country at the beginning of the year 1908 were temporarily obstructed by the financial conditions which then prevailed. . . . The lower selling prices we were able to establish because of the reduction in the cost of raw materials induced a large number of people to purchase our products for introduction in old buildings, and the business from this source was largely increased. This was an important feature of the year's work. Increasing the volume of business, we have been able to reduce the margin of profit. This proves an influential factor in extending the field of demand. The employment of publicity and advertising methods have impressed upon property owners the sanitary and economic advantages which the utilization of our Radiators and Boilers afford. This is gradually broadening the demand from all classes of buildings, large and small, not only in the cities but throughout the agricultural districts. The volume of business and the net profits were greater than for the preceding year." 10 Rep. A. R. C. 2.

REORGANIZATIONS CONSUMMATED IN ORDER TO INCREASE CONTROL OF MARKET

PERCENTAGE BASIS

At Time of Promotion			Time of Reorganization				
Corporation	Date	Approximate Per cent of American Output Controlled by Consolidation	Reorganization Corporation to Corporation	Date	Approximate Per cent of American Output Controlled by Old Consolidation at Time of Reorganization	Approximate Per cent of American Output Controlled by the New Interests Taken in	Approximate Per cent of American Output Controlled by New Consolidation
National Starch Manufacturing Company	1890	70%	National Starch Manufacturing Company; National Starch Company	1900	40%	38%	78%
Glucose Sugar Refining Company	1897	85%	Glucose Sugar Refining Company; Corn Products Company	1902	45%	36%	81%
Corn Products Company	1902	81%	Corn Products Company; Corn Products Refining Co	1906	40%	34%	74%
National Salt Company	1899	15%	National Salt Company; International Salt Company	1901	54%	10%	64%
Mount Vernon-Woodberry Cotton Duck Company	1901	73%	Mount Vernon-Woodberry Cotton Duck Company; United States Cotton Duck Corporation	1901	60%	22%	82%
Asphalt Company of America	1899	80%	Asphalt Company of America; National Asphalt Co	1900	60%	10%	70%

REORGANIZATIONS CONSUMMATED LARGELY TO INCREASE CONTROL OF THE MARKET

SECURITY BASIS

Reorganizations	Date	Approximate Per cent of Output in United States Controlled by Old Consolidation	Approximate Per cent of United States Output Controlled by New Interest Absorbed	Approximate Capitalization of Old Consolidations	Issued Capitalization of the New Competitive Interests Absorbed	Aggregate Capital Stocks of all the Constituent Interests Entering Reorganized Company	Capitalization of New Corporation	New Management to be Vested in Directors of Old Consolidation or in New Interests
National Starch Manufacturing Company; National Starch Company	1900	40%	38%	$11,500,000	$9,000,000	$20,500,000	$14,000,000	Old
Glucose Sugar Refining Company; Corn Products Company	1902	45%	36%	37,500,000	18,000,000	55,500,000	84,000,000	Old
Corn Products Company; Corn Products Refining Company	1906	40%	34%	79,500,000	8,000,000	87,500,000	89,500,000	New
National Salt Company; International Salt Company	1902	54%	10%	12,000,000	6,100,000	18,100,000	26,250,000	New
Mount Vernon-Woodberry Cotton Duck Company; United States Cotton Duck Corporation	1901	60%	22%	22,500,000	2,000,000	24,500,000	25,750,000	Old
Asphalt Company of America; National Asphalt Company	1900	60%	10%	39,000,000[1]	3,300,000	42,300,000	59,000,000	New

[1] Considering only what was paid in on capital stock.

tions have been put through solely to reduce the contingent charges on the preferred stock, as was the case when the American Malting Company was reorganized into the American Malt Corporation.

The task of reducing the charges was much complicated by the variety in the kinds of securities used in financial plans. In our methods of diffused responsibility in finance, we long ago inaugurated securities which were intermediate between those of creditor and partner. We have income bonds, preferred and second preferred stocks, all evolved for the purpose of securing capital by a definite but contingent lien on earnings rather than on assets. The covert purpose of these anomalous securities has been to remove from the creditor the right of foreclosure, by giving him a liberal first lien on profits. Liens on earnings can be arranged according to a series of steps. The first mortgage bondholders come ahead of all others and the common stockholders last. For purposes of absolute control over tangible assets, the line between the securities having fixed and those having contingent charges was a most important one, but from the point of view of the yield to the common shareholder, all claims to earnings ahead of his were equally preferential. In general, therefore, there were only three classes of securities, although there were many modifications of each. There was, first, that class of securities with fixed charges the passing of which precipitated legal insolvency. There were, second, those securities having a fixed lien on earnings, but the holders of which had no legal right to throw the corporation into bankruptcy if their claims were not met. Lastly there were those securities which had no preferential claim to earnings, but were the residual legatees to all assets and earnings. The status of these three classes of securities was of the utmost importance in every reorganization. Inadequate earning power to meet the fixed charges on the first class of securities always ended in reorganization, so that one of the chief purposes of reorganization was to reduce the necessary interest payments. The second class, with only contingent claims to earnings, could not lead directly to a reorganization through lapse of payments, although

the readjustment of preferred charges, as in the Malting case cited above, might have been the chief reason for a friendly reorganization to improve the credit of the Company. It can be stated that the securities of the third class, with no special lien on property or earnings, were never the immediate occasion of a capital readjustment. The reorganizations we have to consider where the purpose was to reduce contingent charges, the charges on the second class of securities, were distinctly different from those in which the main purpose was to reduce the fixed charges on the first class. Methods for obtaining the two results will be considered separately, and owing to the simpler character of the reorganizations it will be clearer to discuss cases concerned with the lapse of payments of contingent charges first.

The contingent charges were either interest on income bonds or else dividends on preferred stocks. Income bonds among industrials were rare. Of the forty or more different issues of securities discussed in the historical pages of this book, only two instances of income bonds are to be found, — the Mount Vernon-Woodberry Company's income bonds, and the Standard Rope and Twine Company's consolidated income bonds. In one instance only, the former, were they issued at the time of promotion. Preferred stocks, on the other hand, were issued in connection with practically every financial plan. At the time of organization the preferred stocks were frequently cumulative in their dividend requirements, whereas at the time of reorganization they were usually made non-cumulative. In the former case the purpose was to make them as attractive as possible to investors, in the latter to burden the reorganized corporation as little as possible. When a corporation had a considerable amount of unpaid cumulative dividends standing against it or when the interest warrants of its income bonds remained unpaid for a considerable period of time, the general credit of the company was much injured.[1] And when

[1] For illustration at the present time, February, 1914, the First Mortgage 6 % bonds of the American Hide and Leather Company are well secured and are fortified by liberal earnings and large fluid assets, yet they sell on a 6 % basis. If the Company had no load of cumulative charges on its preferred stock, the bonds would be on at least ½ % better basis, because the general credit of the company would have so much better standing among investors.

a corporation found itself with a constantly accumulating load of unpaid charges, it sometimes arranged for a friendly reorganization that the load might be relieved and the contingent charges lessened. This was one of the chief motives in all four of the United States Leather Company's reorganization plans. It was an important motive in the two United States Cotton Duck reorganization plans, but in that case the difficulty lay with the income bonds of a subsidiary corporation. This idea played no small part, too, in the discussions leading up to the Starch Manufacturing, the National Starch, the United States Glucose, the American Malting, the Pope Manufacturing reorganizations.

Two methods were employed to lessen such contingent charges. One was to give the preferred shareholders some compensation for the accumulated unpaid dividend claims if they would consent to a lessening of the annual rate. The change could be accomplished usually without affecting the status of the common stock. It was the device presented in the first and third United States Leather plans of reorganization. The method could be applied only to the reorganization of corporations which were sure of prosperous times ahead, because the compensation offered the preferred shareholders took the form of additional securities and additional charges. It could not, therefore, be regarded as an expedient likely to afford permanent relief unless the crisis was of very transitory character.[1] The other method

[1] The best illustration of this method of relief from an accumulated load of dividends was the recent financing of the American Can Company. This consolidation was at first unsuccessful and later met with a measure of success. Meanwhile control had been obtained by a small group of speculators. In April, 1913, there had accumulated unpaid dividends on the preferred stock upwards of 33 %. During the year 1912 the profits appeared large, but this was due mainly to the cutting of the charges to depreciation from $2,500,000 in 1911, to less than $1,000,000 in 1912. On the strength of the liberal earnings, the speculators in control forced the price of the common stock from $11.25 to $47.37 within the year 1912, and the price of the preferred from $90 to $126, — all on rumors of liquidation of the accumulated preferred stock dividends. The stocks of the Company with $82,500,000 capitalization became the center of speculation and manipulation on the New York Stock Exchange. In February, 1913, the management sold $14,000,000 5 % debenture bonds to a syndicate of bankers at about 90 %, and with the proceeds the management paid off in April, 1913, 24 % of the accumulated

was to require sacrifices from all the stockholders, preferred and common. The difficulty, here one of justice rather than expediency, was to arrange the sacrifices so that they should be fair to each interest. When a common stock was selling for less than $10 a share, it made very little difference what plan was suggested, as the general opinion, registered by the market price, was that hardly any plan would probably benefit the stock to any extent. Considerable and drastic sacrifices could then be required of the common stockholders. But if the common stock had a market value, well above $10 a share, it was essential that the plan should not be too stringent, as the public holders believed their common shares would ultimately yield some income in the normal course of the business. The ordinary method of readjustment in such a case was to require the preferred stockholders to surrender their claim to accumulated dividends, and to accept a security bearing a lower rate of income, and at the same time to require the common shareholders to undergo a severe cutting down of the par value of their holdings. If the plan bore particularly heavy on one class or the other, it was frequently necessary for the reorganization committee to form a new corporation to take over those securities of the old that consented to the plan. This had to be done in both the Leather and Malting cases, where the reorganizations were accomplished without legal insolvency. The greatest difficulty, perhaps, lay in bringing about the consent of the common shareholders, even though the reorganization was distinctly in their favor. Low-priced securities are largely carried by brokers on margin and their holders show an almost unaccountable inertia. The adjoining tables summarize the use made of two methods of reducing the contingent charges.[1] (Tables 1*a* and 1*b*.)

dividends. The bankers offered the bonds to the public at 97½ %, but investing interests showed little confidence in the credit of the company. The syndicate could not maintain the price of their bonds and the market for them fell to 92 %.

[1] The method of changing stock into bonds, even though the total charge was much less, could not have been used except in cases where the normal earning capacity of the corporation was well above the proposed new interest charges. Even then it was a dangerous expedient as the fixed charges on the new securities made more possible a forced reorganization, because of lapsed payments. In general, too, it was bad policy as any form of bonded debt tended to injure the

When only the contingent interest charges became a burden, the reorganization could usually be consummated without resort to the courts. If, on the other hand, the corporation found itself unable to meet its fixed charges, a receivership usually followed and ultimately a drastic reorganization. An essential purpose of such a reorganization would then be either to reduce or to eliminate all fixed charges, both of which results might be accomplished in either of two ways, — the bonds could be reduced in amount or rate, or the interest charges could be made contingent. Sometimes a compromise of the two devices was adopted, in which new bonds with lower interest rates were given for part of the old bonds, and preferred stock with a high rate of non-cumulative dividend for the other part. This was the method pursued in the final United States Leather Company's reorganization.

Bondholders were usually unwilling to suffer a reduction either in the amount of their lien or in their rate of interest, and neither expedient was resorted to until it was entirely clear that the reorganized corporation could not endure the old fixed charges, and that the other security holders were willing to make conspicuous sacrifices. If the security behind the bonds had become markedly weak it was easy to obtain their refunding. For example, when, in 1907, it was clear that the real property behind the old Starch Manufacturing Company's bonds had depreciated below the outstanding issue, the majority of the bondholders were willing to take $83\frac{1}{3}$ % of new bonds guaranteed by a stronger corporation. Such a case is, however, unusual.[1] Ordinarily the bondholders will seek to enforce their claims at law, and only when they find that their position is insecure

general credit of the corporation. The other method of lessening the contingent dividend charge, by requiring a change from one form of stock into another, was the more conservative. The first two cases cited in the second table were instances of reorganizations to extend the control of the market. The management believed, therefore, that the new corporation could endure an increased contingent charge.

[1] In this particular case, notwithstanding the fact that the assets behind the old bonds were of little value, and that the Corn Products Refining Company was under no legal obligation to support the Starch Manufacturing Company's bonds, there were a number of holders who refused to make the change, and sought to exact onerous terms from the Corn Products Refining Company.

will they consent to accept a lessened principal or a lessened interest rate.

When the conditions of a corporation reached such straits that sacrifices on the part of its bondholders were required, it was found a wise policy to change the funded debt into a contingent liability — in other words, to force the bondholders to become stockholders. Frequently a new funded debt was created to pay for the assessments forced from the owners of all classes of securities; but quite as frequently the bondholders were persuaded to become stockholders on the distinct understanding that no superior lien should be placed on the property. Thus in the final Asphalt reorganization, the old bondholders consented to take 50% of their holdings in new preferred stock but the conditions of issue were so firmly fortified that not only were no bonds to be authorized, but the Directors were prohibited from incurring more than a small floating debt. When preferred stock was substituted for bonds it not infrequently happened that the dividend was placed at a higher rate than the old bond interest, yet this dividend was usually not cumulative, or cumulative only after an interval of some years. The result was thus a distinct lowering of the fixed charges, although the contingent charges showed an appreciable increase. The table given on the preceding folded leaf summarizes the various conversions of funded debt bearing fixed charges into stock with or without contingent charges. (Table 1*c*.)

4. *Summary of Expedients*

Generalizations drawn from an array of statistical facts are frequently of little value because of the ease with which the facts may be selected to prove the truth or the error of any general statement. Little of universal application can be deduced from the few cases of reorganizations discussed in the descriptive part of this book. Yet, as these cases were selected at random more as types of the causes of failure than of the expedients of reorganization, the summary results have whatever logical significance a mere random selection of evidence permits. The effects, in the thirty-two plans of reorganization described,

on the fixed and contingent charges of the corporations are stated in the adjoining table. (Plate A.) Owing to the varying magnitude of the corporations described mere numerical averages are valueless. Percentages, too, convey little significance because a slight change in charges, when the original charge was small in amount, is indicated by a disproportionately large percentage.

Leaving out all exceptional cases, and those in which the reorganized company had charges for the first time, there remain twenty-seven cases in which a comparison is of possible value. An average of these shows that the new fixed charges were about three-fourths [1] of the fixed charges of the old corporation. Of those reorganization plans arranged primarily to extend the control of the market, — seven out of the thirty-two plans, — only one showed a decrease in fixed charges. The average of the new fixed charges was over twice [2] the fixed charges of the corresponding corporations before reorganization. Of the other group, — those plans, twenty-five in number, arranged to give immediate relief from financial burdens, — twelve showed a lessening of fixed charges, seven the same fixed charges before as after reorganization and six a distinct increase. For the entire group, the average of the new fixed charges was about two-thirds [3] of the old.

Comparisons of the fixed and contingent charges taken together are somewhat more satisfactory because there are fewer exceptional cases which need to be omitted. Of the thirty-two plans, ten show increases in fixed and contingent charges and the remaining twenty-two, decreases. On the average the new fixed and contingent charges of the reorganized company were about five-sixths [4] of those of the old corporation. Taking those plans only which were arranged with a view of extending the control of the corporation over a wider field, four out of the seven show an increase in fixed and contingent charges, and three,

[1] 78 %. In stating these comparisons, it is fully realized that they have little general significance, owing to the relatively few cases discussed and the exceptions and manipulation of figures upon which they depend. They are believed, however, to indicate general tendencies in industrial reorganizations.

[2] 204 %. [3] 67 %. [4] 83 %.

a reduction. As a whole, the group shows that the new fixed and contingent charges were about the same as the old.[1] Considering the other group, — reorganization plans arranged to relieve financial distress, — nineteen out of the twenty-five show a decrease in fixed and contingent charges, and six an increase. Taken as a group, the average of the new fixed and contingent charges was about four-fifths[2] of the old. A detailed statement of the various changes in fixed and contingent charges can be seen in Plate A.

Although the changes in gross capitalization on account of reorganization are far less important than the changes in the amount of fixed and contingent charges, they are significant as indications of a certain recognition among business men of the principle that capitalization should be made commensurate with earning power.

It has often been pointed out that, in railway reorganizations, the total gross capitalization has usually been increased, although the fixed charges were distinctly lessened.[3] Large amounts of preferred and common stocks were issued to take the place of senior securities. This was perhaps expedient, because of the intangible values of a railroad; its right of way and its franchise are of indeterminate value when measured in terms of earning power. The decade following the period of railroad reorganization has vindicated the somewhat extravagant capitalization placed upon the larger systems of the country, because the earning power of railroads expanded with the prosperity of the nation. But industrial reorganizations have followed a different policy. Instead of increasing the gross capitalization, in the belief that the reorganization was necessitated by general rather than by special causes, the men who arranged the plans of industrial reorganization saw clearly that failure was due to an inherent weakness of the enterprise, and that no mere change in general business conditions could bring about a radical change in its fortunes. They therefore reduced the capitalization

[1] New 107 % the old. [2] 79 %.

[3] Daggett, *Railroad Reorganization*. Dewing, "The Position of Income Bonds, as illustrated by those of the Central of Georgia Railway," XXV *Q. J. E.* 396.

to such figures that if the company proved successful, some dividend could reasonably be expected on the common stock.

The table given on the next plate shows the changes in gross capitalization brought about by the reorganization. As in the case of the table of changes in fixed and contingent charges, the gross figures convey little real idea of the conditions. The percentages, however, may be averaged and so give results that are significant. Of the thirty-two plans discussed, it appears that the amounts of new securities bearing fixed charges, the lapse in the regular payment of which would create legal insolvency were actually greater than the amounts of old securities of a similar nature sixteen times; they were less eight times and remained the same eight times. This proportion of cases, taken together with the tendency noted in a previous paragraph to decrease the fixed charges themselves, indicates that reorganization plans frequently decreased the interest rate on bonds and at the same time increased the principal of the lien. This condition, quite pronounced in some cases, was the result of a compromise between the reorganization committee, which demanded at least temporary sacrifices from bondholders, and the bondholders themselves who demanded the full principal of their lien. (For details see Plate B.)

Turning to the classes of securities bearing fixed and contingent charges, the comparison has nothing so marked to show. Of the thirty-two plans, fifteen showed an increase in such securities, fourteen a decrease, while in three cases the securities bearing fixed and contingent charges remained the same. Little or nothing of significance can be gained by separating those reorganizations arranged for the extension of the market from those necessitated by financial distress. Apparently individual and specific motives operated in each case in determining the proportion of new bonds and preferred stocks to the old.

If the entire volume of issued securities is considered, it appears that seventeen out of the thirty-two plans show decreases, fourteen increases, and one only remained the same. In average proportions it appears that the total new securities were 89% of the volume of the old securities. This reduction in the

volume, although involving an increase in the proportion of bonds, is distinctly different from the results shown in railroad and traction reorganizations, where the tendency has been to decrease the securities bearing fixed charges, but to increase the income bonds, and the preferred and common stocks.

The task of summarizing the various expedients and the results which were accomplished by the reorganization of industrial corporations is simpler than the apparent complexity of the subject would seem to indicate. Omitting the few exceptions where reorganization was necessitated by other circumstances than financial failure, all reorganizations have sought to relieve the accumulated and unmanageable floating debt brought about by the deflection of money from the needs of the business to the payment of interest and dividend charges. This was each time the immediate cause of the crisis, and its relief the first consideration in any reorganization plan. But it was not the only consideration, for the conditions which brought about the financial disaster were fundamental in character and pointed to some weaknesses in either the trade or the financial policy of the corporation. With this in mind, all plans of reorganization have sought either to improve the corporation's relative position in the industry, by securing to it a greater control and an improved management, or else to reduce the fixed and contingent charges so that the amounts required for interest payments should be within the minimum earnings of the corporation, and the preferred stock dividend requirements no longer a hopeless burden upon the future credit of the reorganized company. A successful reorganization plan proposed, therefore, more than a mere palliative; it sought to achieve the financial rehabilitation of the corporation along lines leading to permanent success.

TABLE SHOWING THE PARTY RECEIVING THE PREMIÈRE, FIRST LIEN, SECURITY AT REORGANIZATION FOLLOWING FAILURE

Reorganization	Date	Première Security	Who Received Première Security
National Cordage Company; United States Cordage Company	1893	Bonds	Floating Debt
United States Cordage Company; Standard Rope and Twine Company	1895	Mortgage Bonds	Stockholder's Assessment
Standard Rope and Twine Company; Standard Cordage Company	1905	Mortgage Bonds	Bondholders
United States Realty and Construction Company; United States Realty and Improvement Company	1904	Debenture Bonds	Preferred Stockholders
American Bicycle Company; Pope Manufacturing Company	1902	First Preferred Stock	Stockholder's Assessment
Pope Manufacturing Company; Pope Manufacturing Company of Connecticut	1908	Debenture Notes	Syndicate
American Malting Company; American Malting Company	1899	Mortgage Bonds	Bankers Furnish'g New Money
New England Cotton Yarn Company; New England Cotton Yarn Company	1903	Mortgage Bonds	Undisturbed
Union Mills; Union Mills	1913	First Preferred Stock	Corporation Surrender'g Lease
Mount Vernon and United States Cotton Duck Company; Consolidated Cotton Duck Company	1905	Mortgage Bonds	Undisturbed
Consolidated Cotton Duck Company; International Cotton Mills Corporation	1910	Notes	Syndicate
International Cotton Mills Corporation (N. Y.); International Cotton Mills Corporation (Mass.)	1913	Notes	Syndicate
National Asphalt Company; General Asphalt Company	1902	Preferred Stock	Bondholders
United States Shipbuilding Company; Bethlehem Steel Corporation	1904	Bonds	Bondholders' Subscription